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Challenges facing an autonomous Central Bank of Nigeria

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CHALLENGES FACING AN AUTONOMOUS CENTRAL BANK OF NIGERIA

By

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I. INTRODUCTION

The central bank of any country occupies the apex of the monetary and financial structure of that country, and carries out functions that can be sufficiently differentiated from those of the other financial institutions such as the commercial banks, specialised or development banks and the non-bank financial intermediaries. Its functions are generally performed in the national economic interest for which profit motivation is not a major consideration. These functions include:

(a) partial or sole right of note issue which empowers it to regulate the currency in accordance with the requirements of business and the general public;
(b) general banking and associated services for the government;
(c) custody of cash reserves of commercial banks;
(d) custody and management of the nations foreign exchange assets i.e. reserves of international currency;
(e) bankers' bank and "lender-of-last-resort" which involves it in the provision of credit facilities in the form of rediscounts or collateral advances to commercial banks, discount houses, bill brokers and dealers or other banking institutions;
(f) settlement of clearing balances between the banks, and the provision of facilities for the transfer of funds from one important centre to another;
(g) prudential regulation of the banking system; and
(h) control of credit in accordance with the need of business and the economy generally and for purposes of carrying out the broad monetary policy adopted by the government.

These functions are generally interrelated and complementary and hence it may represent a futile exercise to attempt to rank them in order of importance. What needs to be emphasised is that these functions must be discharged in the best interest of the society without regard to profit as a primary motivation. But putting aside the interlocking relationship between and among the functions listed above, the control of credit has become the main function of a central bank as it embodies the fundamental issues involved

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in central bank monetary management. In fact, the issue of central bank independence which has generated a great deal of controversy world — wide and over time, revolves around the degree of autonomy a central bank should be allowed in formulating and implementing effective monetary policy. Before proceeding to the analysis of the challenges facing an autonomous Central Bank of Nigeria, it is helpful to have a clear understanding of what the autonomy or "independence" of a central bank implies. A pertinent question here therefore is autonomy for what purpose and independence of whom?

In answering the above question, it is necessary to bear in mind that the ultimate responsibility for deciding the major objective(s) a nation should pursue with its monetary policy at any point in time is that of its government and it is the government, that empowers the central bank to exercise the power of note issue as well as monetary control in the national interest. Therefore the right of the government to participate in the affairs of the central bank cannot be called to question. This right is generally exercised through sole or partial ownership of the capital; and/or the appointment of all or some of the directors and chief executive officers; and/or a share in its profits. In spite of the increasing participation in the affairs of a central bank by the government, the advocacy of central bank autonomy has stood the best of time.[1]

An autonomous central bank enjoys a relationship of mutually beneficial independence with the other government agencies that are involved in macroeconomic management, especially the Treasury which has responsibility for fiscal policy. The need to ensure its accountability precludes the central bank from being accorded status that make it independent of the government. Therefore central bank autonomy should be seen as a position of semi-independence or "independence within government". While national economic interest demands a regular and whole-hearted co-operation and consultation between the central bank and the government (especially the Treasury), the effective performance of its specialised functions and duties demands its placement in a position to carry out its function of monetary management unhindered by political interference. To summarize, the case for central bank independence may be anchored on the following premise:[2]

(a) the need to prevent the government from misusing central bank as an instrument for financing persistent and growing budget deficits which causes destabilizing monetary expansion and exacerbate inflationary pressures;
(b) the need to insulate monetary policy from political pressures;
(c) the desirability of ensuring monetary credibility and of empowering the monetary authority to fight the socio-economic evil of inflation;

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1. *The papers presented by Chris Nemedia and B. A. Oke at WAIFEM Seminar on Issues in Central Banking and Bank Distress examined in some details the issues pertaining to Central Bank Autonomy (1998): Chris Nemedia, "Issues in Central Bank Independence; B. A. Oke, "Central Bank Independence in Developing Countries: A Comparative Analysis".*
2. *See WAIFEM, Issues in Central Banking & Banking Distress in sub-Saharan African Countries.*

(d) the recognition of the technical and specialised nature of monetary management;
(e) the necessity to bring in a beneficial outside input into government policy formulation and implementation; and
(f) the support from persuasive empirical evidence of the inverse relationship between central bank independence and the rate of price inflation.

Against the above introductory background, I shall analyse in the main body of this paper, three major challenges facing an autonomous Central Bank of Nigeria (CBN), namely:

(a) the attainment and maintenance of price stability;
(b) the maintenance of exchanges rate stability;
(c) the restoration and maintenance of a sound banking (financial) system in the face of widespread and persisting distress in the nation's financial sectors.

II. ATTAINMENT AND MAINTENANCE OF PRICE STABILITY

Price stability has been at the centre of monetary policy debate but the consensus has widened that stable prices represent the best contribution monetary policy can make to the performance of the real sector of the economy. As the nation's monetary authority, an autonomous Central Bank of Nigeria (CBN) faces the challenge of ensuring a stable value of the nation's currency, the naira. Safeguarding the value of the naira implies the maintenance of domestic of price stability as well as of a stable exchange rate.

II.1 POLICY OBJECTIVES

In pursuing price stability, the CBN must ensure that its monetary policy is consistent with the macroeconomic Objectives which the Federal Government of Nigeria wishes to pursue at any given point in time. Often, the major macroeconomic objectives of the government are defined to include:

(a) the acceleration of the growth and development of the economy with a view to raising the standard of living of the people and alleviating the widespread poverty in the society;
(b) the reduction of the rate of unemployment;
(c) the attainment of a more equitable income distribution; and
(d) low rate of inflation or price stability.

The fact that the government always include the maintenance of price stability in its list of macroeconomic objectives while the CBN also explicitly include the four major macroeconomic objectives of the government stated above in its periodic statement of the goals of monetary policy may tempt a socio-economic observer into thinking that the task of monetary management is simplified by the fact that both the CBN and the Federal Government usually pursue the same broad macroeconomic objectives. This conclusion is however far from the reality of the situation, not only because the mere listing of objectives do not constitute their faithful pursuit, but also because of the existence of complex and often conflicting relationships among macroeconomic objectives. Two major constraints to CBN's ability to maintain price stability need to be stressed in this context. The first is that monetary policy is not the only instrument for attaining price stability; fiscal policy also influences aggregate demand and consequently the movement of the general price level (inflation). The second major problem is that the objectives of macroeconomic policies are not necessarily and always mutually consistent. Thus, an autonomous central bank may be faithfully pursuing its principal objective of maintaining monetary stability while the fiscal authorities, for example, may be preoccupied with the pursuit of a different objectives which may negate the efforts of the monetary authority in the short-run.

In the process of monetary policy formulation therefore, the CBN should first address the problems of tradeoff among and between the four major objectives, in collaboration with the other agencies of the government responsible for other areas of macroeconomic and even sectoral policies. It is necessary to stress that the attainment of all or any of the goals of macroeconomic policies requires the co-ordinated efforts of the other government agencies responsible for fiscal, debt management, incomes policies among others. Failure to co-ordinate fiscal and monetary policies will and has on innumerable occasions and in many developing countries wrecked havoc on the pursuit of macroeconomic stability by the monetary authorities. Thus, the first challenge an autonomous CBN faces in formulating monetary policy is that of ensuring that its overall stance of monetary policy is consistent with the major goals the government sets for itself at any particular point in time.

At this juncture, let us briefly examine the inherent conflicts or tradeoff observable among the four macroeconomic objectives of primary importance to governments of developing countries. First, is the inherent conflict between the goals of full employment and price stability. The pursuit of full employment which is a very desirable objective in its own right often invariably raises wages and prices beyond the productivity gains and exacerbate the problem of price inflation. The various bottlenecks encountered in the process of accelerating production and the presence of institutional pressures as the economy moves closer to full employment are the major factors that cause the worsening of the inflationary pressures. Secondly, when the prevailing economic conditions indicate the co-existence of a high rate of unemployment and inflation, which is quite often the case here in Nigeria and similar developing countries, the simultaneous pursuit of price stability and a low rate of unemployment becomes problematic. If for instance, the Federal Government's macroeconomic priority objective is to pursue a high rate of employment (or a low rate of unemployment), the CBN's goal of price stability could face a conflict with an expansionary fiscal policy.

Thirdly, the co-existence of a balance of payments surplus with a high rate of inflation poses a challenge to monetary management, which in turn affects policy measures aimed at restoring domestic and external sector equilibrium simultaneously. For instance, domestic policy of deflation could worsen the imbalance in the external sector by stimulating export and discouraging imports; so where do we strike the balance?

Fourthly, there is also a tradeoff between the pursuit of a high rate of economic growth and external sector balance. For instance, a vigorous stimulation of economic growth which significantly raises the income levels could also stimulate imports particularly under a liberalized trade regime and cause short-run adverse movements in the balance of payments. By boosting importation it can cause a current account deficit or worsen an existing one and even end up in an overall balance of payments dis-equilibrium where no adequate offsetting capital inflow materializes.

The tradeoff challenges to monetary policy formulation boils down to that of co-ordinating monetary policy objectives with those of the other macroeconomic managers to ensure internally consistent macroeconomic objectives. It should be possible for the monetary authorities in collaboration with the other relevant arms of the government to prioritize the pursuit of the four major objectives at any point in time by taking into full consideration the socio-economic conditions prevailing in the country.

Having decided on the stance of monetary policy as well as the feasible and realistic objectives to be pursued by monetary policy, the next challenge from monetary management is how best to apply the instrument of monetary management under a deregulated economic environment in order to achieve the goal of monetary policy.

II. 2 MONETARY POLICY STANCE

The dynamics of socio-economic situation is such that monetary policy has to oscillate between a policy of credit ease and that of credit restraint. The direction CBN takes with its monetary policy at any point in or period of time depends on the prevailing socio-economic conditions for which it must he sufficiently equipped to collect and analyze adequate quantitative data on both the real and the monetary sectors of the economy.

In a situation where there is excessive demand pressures in the economy and price inflation becomes a threat to monetary stability, it behoves the central bank as the monetary authority to institute a policy of credit restraint in order to ensure relative price stability. In general, this involves raising interest rates to increase the cost of money and restraining the growth of bank reserves and money supply. This is expected, subject to time lag, to curtail borrowing and spending by the economic agents (household, government, and business sector). For a policy of monetary restraint to be effective in controlling aggregate demand, it is highly desirable that the fiscal operations of the government do not negate it by running a persistent budget deficit. An autonomous CBN stands in a better position to employ such tools as open market operations, or reserve requirement, discount window operation, or moral suasion, either singly or in the form of a package deal, to formulate a restrictive monetary policy.

In the opposite situation in which the economy falls into a deep recession or depression, the central bank in its monetary policy management function is faced with the need to reverse its policy gear from a tight monetary policy to one of expansion or credit ease. The aim would be to stimulate aggregate demand with the intention of steering the economy into the path of recovery and growth. This is done by easing credit conditions through the manipulation of its tools of monetary management to increase bank reserves which in turn should lead to an increase in the supply of bank credit or loanable funds and induce the bank to liberalize their terms for granting credit. Under an expansionary monetary policy, the CBN faces the choice of either engaging in open market purchases of government securities and/or reducing the legal reserve requirements imposed on the banks. All things being equal, the banks are induced to increase their lending while the investors and consumers may also increase their spending on investment and consumption activities. The resultant stimulation of expansion of economic activities in both the financial and the real sectors of the economy is expected to lead to the attainment of the ultimate objectives of output growth and increased employment. The formulation of monetary policy ill terms of target rates of growth in selected monetary aggregates rests on the implicit assumption by the monetary authorities of the existence of an important linkage between changes in the selected monetary variables which represent the intermediate target of policy and the ultimate policy targets of national income, employment and prices.

II.3 REVIEW OF CBN'S MONETARY POLICY INSTRUMENTS

The instruments of monetary policy available to the CBN under the prevailing deregulated economic environment include open market operations, discount window operations, reserve requirements and moral suasion.

(i) Open Market Operations (OMO)

In economies with developed financial markets, OMO has become a powerful market-oriented tool of monetary management which enables the monetary authorities to influence the cost and availability of bank reserves and bring about desirable changes in bank credit and the money supply. When there is need to curtail credit expansion, for instance in an inflationary situation, the central bank undertakes a sale qualified securities in the money market. This reduces the cash reserves of the banks and curtail their credit expansion operations thereby causing monetary contraction. This in turn may cause interest rates to rise and discourage investment, lower aggregate spending and dampen the inflationary pressures. The banks may, of course resort to borrowing from the central bank as the lender of last resort and thereby give the central bank the added opportunity to reinforce its open market operations by increasing its lending rate or/and rediscount rate. Since the effectiveness of OMO as an instrument of monetary management depends on the existence of a well developed, integrated and interest sensitive financial markets, which is as yet lacking in our financial environment, the fostering of the undevelopment of the Nigerian financial markets persists as an important challenge to an autonomous CBN.

(ii) Discount Rate and Discount Windows Policy

This is the oldest instrument of monetary policy which enables the central bank to influence the credit operations of the commercial banks that seek temporary financial accommodation from the central bank "discount window." Discount window operations are generally carried out at penal rates and banks resorting to the discount window are required to provide acceptable collateral in the form of government short-term securities or other prime-rated securities. A change in the discount rate usually induces changes in other interest rates in the same direction. In addition, money market participants, business community, and informed public tend to interpret changes in central bank discount rate as a signal of central bank monetary and credit policy stance and hence it has an important announcement effect.

(iii) Reserve Requirements

Reserve requirements, initially designed as tools for maintaining bank liquidity, have become useful instruments of monetary policy. In a period of credit restraint, reserve ratios are increased while they are lowered under a policy of credit ease. Reserve requirements are lowered under the implicit assumption that the gains in free reserves by the commercial (also merchant) bank will be used by them to increase their earning assets which thereby should increase total bank credit and the monetary stock of the economy.

The CBN is empowered to impose a number of variable reserve ratios on the banks. These include, cash ratio, liquid assets reserve or liquidity ratio, and several types of supplementary reserve requirements such as the stabilization securities. The cash reserve ratio and stabilization securities are blunt instruments which are very useful when automatic adjustment in bank liquidity position is seen as desirable for monetary stability by the CBN. The issue and redemption of stabilization securities produce effects similar to open market operations but caution should be exercised in their use to avoid unintended or counter productive effects associated with its prolonged use.

(iv) Moral Suasion

This involves the use of CBN's power of persuasion, without issuing official directives, to influence the lending operations of the commercial banks in a desired direction in the national interest.

III MAINTENANCE OF EXCHANGE RATE STABILITY

The objective of exchange rate management is to remove misalignment, which may manifest in exchange rate over-valuation or under-valuation, and therefore move the rate to its fundamental equilibrium value which is expected to bring about external balance. Fundamental equilibrium exchange rate (FEER) may be defined as the rate which is expected to generate current account surplus or deficit equal to the underlying capital flows over the business cycle, given that the government pursues internal balance and avoids restricting trade for balance of payments purposes. The FEER is a real rate as distinguished from the nominal rate which is the market equilibrium rate. Thus, a central bank has to worry about the accurate estimation of the economy's FEER in order to determine the extent of deviation of the market exchange rate from the fundamental equilibrium rate and design appropriate exchange rate policy to deal with any misalignment. Various factors such as market inefficiency, misguided intervention and the stance of macroeconomic policy can cause exchange rate misalignment which imposes costs on the economy such as inflation ratchet, unemployment, adjustment cost, impairment of productive capacity and protectionist, among others.[3]

The estimation of the purchasing power parity of the exchange rate (PPP approach) provides the central bank with a pragmatic and second-best solution to the problem of estimating FEER. This is then compared with the observed nominal exchange rate which may either be the existing pegged rate or the market - determined rate under a floating exchange rate regime. The standard policy prescription for removing exchange rate misalignment is to devalue (or revalue) the rate under a pegged system or refrain from intervention in the foreign exchange market and allow market forces to determine the rate by the interaction of supply and demand; or intervene in the foreign exchange market to influence the emerging rate by manipulating the process of supply or demand for foreign exchange when market imperfections or failure assume worrisome dimension. Efficient management of exchange rate requires, in addition to technical competence, a strong commitment by the government to the balanced use of domestic demand management policies to curtain inflation.

Nigeria has since the introduction of a structural adjustment programme (SAP) in 1986 made a significant progress in its search for an efficient exchange rate management system. An initial drastic devaluation followed by persistent and huge depreciation during the first post-SAP decade of the floatation of the Naira, purged the domestic currency of its over-valuation maintained in the pre-SAP years by stringent exchange controls. However, it should be observed that exchange rate being a dynamic economic variable is subject to changes by practically all economic events and government policies affecting balance of payments and even political events. Developments outside the control of a

3. *John Williamson, The Exchange Rate System: Policy Analysis in International Economics (Institute for International Economics, September 1983)*

country can cause changes in the value of its exchange rate in any direction. For instance, a rise in income of a trading partner country can cause an upward shift in its demand for the export of the home country and cause the latter's exchange rate to appreciate. There is a tendency for a country's FEER to continually change whether the country is operating a fixed or floating system. A review of selected ECOWAS countries' (Gambia, Ghana, Sierra Leone and Nigeria) recent experiences with market-determined exchange rate management system indicate the persistent of a downward trend in the foreign exchange value of the domestic currencies. For these countries persistent exchange rate depreciation usually translate into persistent inflation in the face of excessive import - dependence and the openness of the economy, thanks to SAP- induced liberalization of international trade policy. Thus, in spite of the gains recorded in exchange rate management in the review period, the problem of maintaining a stable exchange rate steers the monetary authorities in the face.[4]

A purposeful and beneficial exchange rate management approach by the CBN should therefore ensure that the rate is not allowed to drift persistently downward in the name of deregulation or free market – determination; instead, the Bank should adopt a managed float within an appropriately defined band of floatation. I hasten to suggest here that this is best undertaken within the framework of ECOWAS monetary co-operation programme that requires member countries to harmonize their exchange rate and other macroeconomic polices in preparation for the proposed monetary union of West Africa early in the next millennium.

IV. MAINTENANCE OF A SOUND BANKING SYSTEM

The responsibility for promoting the development of a sound banking system by the CBN has become much more critical than ever before in view of the recent and persisting crisis of bank distress in the economy. In fact, some monetary experts see the maintenance of banking soundness as the microeconomics dimension of monetary management[5].

IV. 1 CHALLENGES

The major sources of the increasing challenge posed by the maintenance of banking soundness to the central bank may be outlined as follows:

(a) deregulation and the opening of financial markets have brought the importance of supervision and prudential regulations of the banks to the forefront of monetary and financial management;

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4. *Chris E. Nnemedia, Exchange Rate Management in Developing Countries: Lessons from ECOWAS Countries (A Paper Presented at the CBN Research Department Weekly Seminar 14th April, 1998)*
5. *Manuel Guitian, Banking Soundness: The Other Dimension of Monetary Policy.*

(b) the 1996 Interior Committee's declaration, "Partnership for Sustainable Global Growth," include the need to ensure the soundness of the banking system through strong prudential regulation and supervision;

(c) widespread experience of banking crisis in many countries over the past few years has made the pursuit of banking soundness ever more relevant;

(d) although banking supervision and prudential regulation, deposit insurance schemes and lender-of-last-resort responsibilities are not generally considered among the broad aims of macroeconomic management; they represent a legitimate policy undertaken because a sound banking system helps monetary authority to achieve its price stability objective; also a sound and stable bank has public good qualities in its own right. There is therefore no doubt that systemic bank soundness is of major interest to all central banks; the CBN not excluded.

For the Nigerian banking industry, the CBN and the Nigerian Deposit Insurance Corporation (NDIC) represent the two complementary institutions charged with the duties and responsibility of supervising the financial system in which the banking system constitute the dominant segment.[6] NDIC is a new establishment and the brain child of the CBN in its search for ways and means of promoting the soundness of the banking system. It was established in 1988 to insure the deposit liabilities of the licensed banks and to provide financial and technical assistance to them and thereby contribute to the quest for a safe and sound banking environment in Nigeria. The original act setting up the CBN in 1958 charged the Bank with, among other things, the responsibility for promoting monetary stability and a sound financial system in the country. The recent policy reforms in the financial sector (1996 and 1997) extend the CBN supervisory authority to cover specialized banks and some non-bank financial intermediaries such as finance companies, discount houses, bureau de change, Primary mortgage institutions and community banks in recognition of the increasing need to ensure the soundness of the entire financial system. The importance of this challenge to an autonomous CBN cannot therefore be over-emphasized.

In the pursuit of this responsibility, the CBN undertakes on-site examination as well as off-site surveillance of the banking system. The overall objectives of both supervisory exercises is to ensure the maintenance of a high quality of banking services by ensuring that the banks operate in conformity with the legislative and regulatory provisions guiding their operations. To this end. the bank examiners and supervisors from the CBN in collaboration with those from NDIC oversee and review the operations of the banks and where necessary, recommend changes in the laws and regulations governing banking activity in the country.

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6. *Chris E. Nemedia, The Supervisory Functions of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation (Paper Presented at the Seminar/Workshop on "Duties and Responsibility of Bonk Examiners and Branch Inspectors, Organized by Chris Nemedia Consultancy Services in Collaboration with Reliable Management Consultancy Services, Lagos 24–26 June 1998).*

The observed limitation of off-site surveillance of the banking system include:

(a) the possibility that a bank could submit wrong and/or incomplete record of its operations either deliberately or inadvertently;

(b) the difficulty of obtaining a satisfactory analysis of a bank's assets and liabilities based on returns alone due to lack of adequate information for evaluating the risk factors attached to a bank's asset;

(c) the fact that banks' periodic returns to the CBN are prepared as at a point in time and therefore incapable of capturing the patterns of bank assets and liabilities; and also the peculiar operational characteristics of a bank since they are prepared for the entire banking system.

To supplement off-site surveillance and improve on the quality of its supervision, the CBN undertakes on-site examination of the banks as a matter of routine exercise but it can also visit a bank for a special examination when justified by the financial conditions of the bank. The regularity of on-site examination of the banks depends largely on the executive capacity of the regulatory authorities and hence the constraint of executive capacity has limited the current practice by the CBN to a bi-annual exercise. The growing distress in the banking system since the early 1990s has imposed a growing burden of bank examination on the CBN and thus elevated banking supervision to the forefront of monetary management. Thus, in addition to ensuring an effective prudential regulations of the banking system, the CBN is faced with the problem of devising the most effective and appropriate way of exercising supervisory intervention aimed at purging the banking system of the prevailing distress in the system as well as ensuring their non-recurrence or minimizing future incidence of such negative developments.

The efforts of the CBN, in collaboration with the NDIC, in dealing with the distress in the Nigerian banking system has involved the following notable policy actions:

(a) issuing of prudential guideline to regulate banking operations;

(b) rendering of financial assistance in exercise of its role as lender-of last resort;

(c) other intervention approaches including moral suasion, imposition of "holding" action, change of management, assumption of control and management, suspension of banking licenses and outright liquidation.

IV. 2 PRUDENTIAL REGULATION OF THE BANKS

The unique functions of the banking system which includes its funds intermediation role in general and its special ability to expand and contract the money supply through its credit operations have impacted to banking services the quality of public good and hence the greater government intervention in banking operations than in other types of private business enterprises. Thus, the official surveillance of the banking system exercised by the CBN is undertaken in the public interest. In particular, the prudential guidelines introduced into the Nigerian banking system in the 1990s to sanitize it, found justification in the following factors or developments:[7]

(a) the rapidly changing banking environment induced by the newly embraced economic philosophy of deregulation and liberalization which was ushered in by the introduction of SAP in 1986;

(b) the ensuing greater competitive and innovative environment which had the tendency of making banking business riskier than it had ever been in the history of banking in the country;

(c) the introduction of deposit insurance by the establishment of NDIC in 1989 which by enhancing the safety of bank deposits had the unintended effect of making banks pay less regard to safety in the utilization of their customers' funds in their lending and investment operations;

(d) the widespread practice of boosting profit with unearned interest income (paper profit) and declaring dividends with consequent erosion of banks' capital base or shareholders funds; and

(e) the acceptance of the Basle Committee's recommendation on the need to adopt a global accounting standard and thereby internationalize the Nigerian prudential banking standard.

The overall objective of the prudential guidelines is to ensure a stable, safer and sound banking system. They are expected to ensure a more prudent approach to, and uniformity in credit portfolio classification, provisioning for non-performing credit, credit portfolio disclosures discover and interest accrual on non performing assets and thus enhance the reliability of published accounting information and operating results.

V. CONCLUDING REMARKS

A central bank whether in developed, transition, or developing economies, occupies the apex of the modem financial and monetary system of its country, the CBN being no exception. It is particularly important that the CBN remains autonomous within the executive arm of the democratic government of Nigeria so that it could exercise its power of monetary management with the required professional competence unfettered by political pressures. Empirical evidence from the economic development history of this country and other African countries and indeed world-wide strongly indicate that a central

7. *Chris E. Nemedia, Prudential Guidelines and their Impact on the Operational Efficiency of the Banking System (Seminar/Workshop Paper on "Duties and Responsibilities of Bank Examiners and Branch Inspectors).*

bank that lacks autonomy by being subordinated to the Treasury or any other arm of the executive branch of the government usually perform poorly with regard to its responsibility for the maintenance of price stability, largely because of its inability to control inflationary financing of budget deficits. It is also important to stress that the functions of the CBN as a public institution should be performed in the national economic interest for which profit consideration should not be a major consideration and devoid of partisan political pressures.

Although the CBN, like other central banks, is saddled with several functions as the watch-dog of the economy and the financial/economic adviser to the Federal Government, the responsibility that poses the greatest challenge to it, is that of monetary Policy formulation and implementation. In broad terms, monetary policy is designed to ensure that the economy attain and maintain domestic as well as external economic and financial stability. A stable economy provides a better environment for the pursuit of economic growth and development through an enhanced mobilization of both domestic and foreign capital for productive investment without which a higher level of employment and improved standard of living cannot materialize. There is a growing consensus that price stability represents the greatest contribution monetary policy can make to foster the performance of the real sector. Without prejudice to the other functions which the CBN's enabling act imposes on it or others that impinges on its role as the banker to the government, the paper isolated three areas which pose the greatest challenges to the professional and specialized competence of the CBN, namely:

— the attainment and maintenance of price stability;
— the maintenance of exchange rate stability; and
— the maintenance of a sound banking system, including the promotion of the development of the financial markets.

The CBN pursuit of price stability should be defined within the framework of the Federal Government's major macroeconomic objectives, be it the acceleration of the growth of the economy or the attainment of full employment or low rate of inflation or a package of these. The fact that there are tradeoffs among these macroeconomic objectives imposes, not only on the central bank but also on the Treasury and other macroeconomic managers, the need to co-ordinate monetary, fiscal, incomes and other policies to ensure that they are internally consistent, instead of working at cross purposes.

Another major fallout of the analysis in this paper is that the CBN faces an important constraint to the effectiveness of its monetary policy under a deregulated environment where the market-oriented policy instrument of open market operations claims pre-eminence, given the fact that the Nigeria financial market remains underdeveloped in terms of it being narrow and shallow. This acknowledged fact should therefore task the ingenuity of the monetary authority in promoting the development of a broader and deeper money market in Nigeria.

The maintenance of exchange rate stability is part and parcel of the task of maintaining domestic price stability. The strong inverse relationship between exchange rate and inflation in Nigeria and similar economies, among other things, imposes on the CBN the need to adopt a stable exchange rate objective as an essential element of its monetary policy even under a flexible exchange rate regime which now dominate the global environment. The heavy dependence of the economy on the rest of the world due to low technological development and lack of industrialization, couple with its increasing openness, under the impetus of globalization, challenges the CBN to adopt a more skillful approach to the management of the floating exchange rate of the Naira. Against the foregoing backdrop, I recommend that the CBN should take the initiative through the forum of the Committee of Governors of ECOWAS Central Banks to regionalise the management of the naira within the framework of a harmonized exchange rate management system based on a band and margin of floatation that would be regionally agreed.

Finally, the paper emphasized the need for the CBN to ensure the restoration and maintenance of a sound banking system on the premise that a well functioning system ensures that the linkages between monetary policy instruments and economic performance operate in conformity with expectation. In particular, a sound banking system would ensure an efficient and stable payment system, promote greater funds intermediation between savers and investors and contribute significantly to the development of the financial market which represents an important instrument for mobilizing savings and investment in a modern economy.

TABLE 1

Exchange Rate of National Currency per US Dollars

Countries	Period						
	1985	1986	1990	1994	1996	1997	1998
Gambia	3.89	6.94	7.88	9.57	9.85	10.20	10.60
Ghana	54.37	89.20	326.33	956.43	1637.24	2049.10	2305.62
Nigeria	0.89	1.76	8.04	22.00	85.00	82.06	83.60
Sierra Leone	6.09	16.09	151.45	601.67	918.94	981.91	1615.11

TABLE 2

Inflation Rate

Countries	Period					
	1986	1990	1994	1996	1997	1998
Gambia	56.6	12.2	5.0	0.2	2.2	n.a.
Ghana	24.6	37.2	34.2	23.7	20.8	n.a.
Nigeria	5.4	7.5	57.0	29.3	8.5	10.0
Sierra Leone	80.9	111.0	17.7	8.8	17.0	n.a.

n.a. = not available

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