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The Conduct of Monetary and Banking Policies By the Central Bank of Nigeria*

by

V. A. Odozi**

I. INTRODUCTION

Monetary and banking policies are usually the responsibilities of the Monetary Authorities which comprise the Central Bank and the Central Government. In Nigeria, while the Central Bank exercises primary responsibilities for initiating, articulating, implementing and appraising such policies, the Bank's proposals are subject to the approval of the Federal Government. To facilitate the understanding of the conduct of monetary and banking policies by the CBN, it is necessary to articulate the theoretical framework of monetary policy, the CBN monetary management techniques, as well as the policy measures adopted since 1986 to reform and strengthen the banking system.

II. FRAMEWORK OF MONETARY POLICY

Although the focus of this paper is on the experience of the CBN in prosecuting monetary and banking policies, it is perhaps useful, as a background to review the general conceptual issues in monetary policy which are linked to banking policies and measures. The review will focus on objectives and instruments, conflicts and controversies and the mechanism for the conduct of monetary policy.

Objectives and Instruments:

As you may be aware, monetary management relies on the control of money stock (however defined) in order to influence other broad objectives which include price stability, high level of employment, sustainable economic growth and balance of payments. These objectives are achieved through the use of appropriate instruments or tools depending on the level of development of the economy in which monetary policy is being implemented. There are broadly two categories of these instruments – direct and indirect. Indirect instruments are usually used in market-based economies where the quantity of money stock can be influenced through the relationship between money supply and reserve money as well as the ability of the monetary authorities to influence the creation of reserves.

The Central Bank influences reserves and hence money stock in diverse ways. First reserves can change if the central bank adjusts the reserves/deposit ratio for banks in such a way as to influence their ability to extend more or less credit, and money stock. Second,

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reserves of banks and hence money stock can change through the change in the Central Bank's discount rate which is the rate at which it lends money to banks as lender of last resort. Third, interest rates may change with the change in the discount rate, especially in developed markets and influence the cost and availability of credit as well as investment and economic growth. Fourth, the monetary authority could also influence reserves by engaging in Open Market Operations with a view to influencing the bank's credit operations by causing changes in the cost and availability of credit. The use of this instrument requires the existence of well developed financial markets in which the amount of government and other securities held by banks and the non-bank investing public is large and the trading in securities is sensitive to the movements in interest rates.

In an underdeveloped financial environment, the tools or instruments of monetary management are limited largely to direct measures which set monetary and credit targets at desired levels. One of the major direct control measures is direct interest regulation by fixing the level or range of interest rates, for example, the specification of deposit and lending rates for banks. Another commonly used direct instrument is the imposition of quantitative ceilings on overall credit operations of the banking system in order to control the impact of credit expansion on money stock. A related direct control measure is the ceiling imposed on sectoral credit allocation to either the government or private sector or both or subsets of either sector.

Conflicts and Controversies:

While all the objectives of monetary policy highlighted above are desirable, they are not equally important in every situation. This explains why monetary policy has a priority focus which is usually a reflection of the stage of development and peculiar circumstances of the economy being considered. For example, in developing countries faced with many structural problems, the achievement of price stability is given a priority in order to avoid price distortions that would constrain the achievement of other objectives of policy. However, any design of monetary policy assumes possible conflicts of economic objectives and therefore the need for trade-offs.

Apart from conflicts among the objectives and instruments of monetary policy and other policies, there are inconclusive debates on monetary theory and practice which have implications for monetary policy. These debates centre on the question of whether the supply of money is subject to the control of the monetary authorities or whether it adjusts passively to demand; the nature of the impact of money stock changes on nominal and real incomes in the short and long-run; the issue of what is the transmission channel of monetary policy; and the debate over whether monetary policy should be based on a fixed rule or whether it should be a matter of complete discretion of the monetary authorities.

The foregoing conflicts and debates notwithstanding, the mechanism for the conduct of monetary policy or management is less controversial as reviewed below.

Mechanism for the Conduct of Monetary Management:

The conduct of monetary policy usually passes through three inter-related stages, namely, policy formulation or design, implementation and review. The institutional environment

for this exercise is usually provided by the Law which defines (i) the relationship between the Central Bank and the Central Government; and (ii) which arm of the Central Government has the final authority on the policies initiated by the Central Bank.

Wherever the institutional framework is in place, monetary policy is formulated by first appraising the recent past and the present and making projections of the likely future trends in the absence of policy changes. This exercise enables policy initiators to present a range of scenarios and policy options to choose from. The policy options are obtained from statistical exercises which show estimates of the rates of money supply growth required to support economic growth under conditions of stable prices, external equilibrium and minimal unemployment. While the theoretical framework of monetary policy is generally applicable, the strategies for achieving the basic objectives differ having regard to the particular economic structure and stage of economic development. It would, therefore, be worthwhile to review the Nigerian experience in the design and use of monetary policy instruments.

III. CBN MONETARY MANAGEMENT TECHNIQUES

Objectives and Legal Basis:

Over the years, and in consonance with the thrust of macro-economic policy, the objectives of monetary policy in Nigeria have been: (i) achieving domestic price stability; (ii) reducing pressures on the external sector; (iii) stabilizing the naira exchange rate; and (iv) inducing increased financial savings, investment, economic growth and employment. As already observed monetary policy cannot achieve all these objectives simultaneously. Consequently, there has to be some prioritisation such that the most critical objectives, in the light of the prevailing economic situation are pursued as the goals of monetary policy.

The authority to formulate and implement monetary policy is vested in the Central Bank of Nigeria (CBN) as outlined in the CBN Decree 24, 1991 and the Bankers & Other Financial Institutions Decree 25 of 1991. These laws which replaced previous legislations on the subject enjoin the CBN to promote monetary stability and a sound financial system in Nigeria under the overall guidance of the Federal Government. The Bank is required to make proposals to the President (Head of State) who has the authority to accept, amend or reject such proposals. The CBN is obliged to implement the monetary policy approved by the President. Put differently, while the CBN initiates monetary and banking policies, they are implemented only when approved by the Federal Government. Prior to 1988, the CBN monetary and banking policy proposals were passed to the Federal Executive Council through the Federal Minister of Finance for integration into the Federal Government Budget. Since 1988, the CBN proposals have been sent direct to the President. They are, however, still subject to consideration by the various councils of Government namely, the Federal Executive Council, the National Council of State and the Provisional Ruling Council.

Formulation Techniques:

Monetary policy formulation by the CBN relies on the technique of financial programming which is used in most countries. The starting point of such a programme is

a comprehensive review of recent economic performance, as well as the current and anticipated problems. Essentially, the programme attempts to estimate an optimum quantity of money consistent with the assumed targets for GDP growth and inflation rates, and the external reserves (balance of payments position). On the basis of the computed optimum money supply, the economy's absorptive domestic credit is derived, thus permitting growth targets to be determined for the key intermediate policy variables of money supply and aggregate domestic credit is then allocated between the public and private sectors. The portion allocated to the government is determined, as indicated earlier, by the size of the budget deficit to be financed by the banking system (Central Bank and commercial/merchant banks). What is left is then allocated to the private sector, thus allowing the Central Bank to determine the credit ceiling to be imposed on banks when monetary control depended on the direct approach. With the movement to indirect monetary control techniques since 1992, credit ceilings have been largely phased out and instead the authorities use the market-based instruments, especially Open Market Operations to limit the banks' reserve balances to optimum levels and thereby restrain their credit creating capacity.

Instruments of Policy:

During the period of direct monetary control, the policy instruments comprised credit ceilings imposed on banks, administratively fixed interest and exchange rates and stipulation of sectoral credit allocation. The prescription of cash reserve requirements and special deposits was also undertaken to support monetary management. As the prolonged use of the direct instruments had adverse effects on both the economy and the effectiveness of monetary policy, a decision was taken to change the strategy of monetary management to the indirect approach involving the use of market-based instruments such as reserve requirements, the discount rate and Open Market Operations. This decision was also in line with the on-going strategy of deregulation as a tool of economic management. To move to the system of indirect monetary control, a policy framework was designed for the development and promotion of a deregulated, competitive and sound money market. The plan involved the deregulation of interest rates, partial deregulation of the market for government debt instruments and strengthening of the legal and institutional framework. Steps were also taken to deal with financial distress, improve the data base and reduce substantially the excess liquidity in the economy. The need to reduce the excess liquidity in the economy led to the reintroduction of stabilization securities issued to banks to sterilize their excess reserves.

The final movement to the indirect monetary control system was in two phases. The first phase was introduced in September 1992 when the CBN selectively lifted the imposition of credit ceiling on individual banks which met some specified criteria comprising specified cash reserve and liquidity ratio requirements, prudential guidelines, statutory minimum paid-up capital requirement, capital adequacy ratio and sound management. Finally, on 30th June, 1993, the CBN formally introduced Open Market Operations as the major tool of monetary policy. However, in the face of the parlous state of the economy as at the end of 1993 and the pressure for a review of the nexus of policies under the SAP, the Federal Government in its 1994 Budget reintroduced administered interest and exchange rates in an attempt to dampen inflationary pressures and restore some degree of macro-economic stability.

Co-ordination of Monetary, Fiscal and Other Economic Policies:

It is desirable for all government economic policies to be co-ordinated so as to have some measure of internal consistency necessary for all the policies to achieve the desired impact on the real productive sectors. A monetary programme is built on some basic assumptions regarding: the GDP growth rate, inflation rate, fiscal deficit and the implied banking system financing of the government borrowing requirement, as well as the balance of payments position. The CBN, as the initiator of monetary policy, usually consults all the agencies of government responsible for relevant data and projections. In addition, the CBN also prepares a document proposing other desirable sectoral policy measures consistent with the achievement of the objectives of monetary and other macro-economic policies.

Implementation of Monetary Policy:

After the approval of CBN's monetary policy proposals by the Federal Government, the relevant measures are communicated to banks and other financial institutions in the form of a Monetary Policy Circular issued by the Central Bank. Penalties for non-compliance with the prescribed guidelines are also indicated in the Circular. To monitor the activities of financial sector operators, the CBN conducts periodic target and special examinations of the books of all licensed banks which are also expected to submit regular returns on their operations to the CBN. The examinations and returns from the institutions as well as current economic developments permit an evaluation of the extent of compliance with the Circular, the general effects of the policy package on the economy and the need to undertake a review of the policy measures.

From the foregoing analysis, it is clear that monetary policy is linked to banking policy in at least two ways. First, monetary policy is implemented through the banking system. Second, monetary policy influences the activities of banks. Thus, while some banking policy measures share the same origin as monetary policy measures, other banking measures are extensions or mere follow-ups of monetary policy.

IV. THE BANKING SECTOR BEFORE REFORM

Nigeria's banking sector witnessed rapid growth between Independence in 1960 and 1985 in terms of its structure, development and contribution to overall performance. The sector generally provided services that were necessary for a modern economy. It developed an acceptable medium of exchange and facilitated the trade and production processes of the country through the mobilization and channelling of domestic savings. Nevertheless, the banking sector did not develop the level of sophistication necessary for it to perform optimally within the national economy. The major constraints and shortcomings were inadequate capital base, imprudent lending policies which resulted in large amounts of doubtful debts, concentration in short-term lending, inadequate competition and poor quality of services. Furthermore, capital deficiency in the development finance institutions seriously constrained their performance. Several of them relied mainly on capital and loan funds from government and on government-

guaranteed loans to fund their operations. A general constraint of the banking sector was the acute shortage of technically qualified manpower which was a major cause of low management capacity and poor quality of financial services.

Thus, on the eve of economic and financial reform in 1986, a significant level of distress prevailed in the banking sector which could be traced to macro-economic and policy instability; inadequacy of financial portfolios and excessive regulations especially in the areas of interest rate determination and credit allocation; and poor management. The controls on interest rates and the financial markets were aimed at influencing the flow of credit in favour of preferred sectors and the level of domestic investment. On the contrary, the controls tended to discourage the holdings of domestic financial assets and encourage capital flight. The use of credit ceilings reduced competition and prevented efficient allocation of resources. Other problems caused by financial controls included restricted financial intermediation through specialised lending agencies without complementary savings mobilization schemes and unduly large public sector borrowing from the banking system which tended to crowd out the private sector if not destabilise the economy.

V. MEASURES ADOPTED TO STRENGTHEN THE BANKING SECTOR SINCE 1986

The changes in the banking sector since 1986 were designed to increase competition, strengthen the supervisory role of the regulatory authorities and streamline public sector relationship with that sector. One of the initial actions in those directions was the effort made to enhance banking sector efficiency through increased competition and management. With the introduction of the reform programme, government licensed far more new banks than at any comparable period in the nation's financial history. New proprietors of banks were given licences provided they satisfied the requirements as provided in the enabling laws. Between 1986 and 1992, a total of 79 new commercial and merchant banks, with 1,068 bank branches, opened for business. In the previous six years (1980–1985), only 14 new banks with 644 branches had opened for business. Thus, at the end of 1992, the total number of banks was 120 with 2,391 branches compared with 40 with 1,323 branches at the end of 1985. However, the number of licensed banks fell to 116 in 1994 following the liquidation of 4 banks while the branch network increased to 2,541. In order to strengthen the system and protect it from the adverse effect of such liberal policy on the licensing of new banks, the minimum paid-up capital of banks was increased in 1989, 1992 and 1993. As of now, the minimum capital requirements for commercial and merchant banks stand at ₦50 and ₦40 million, respectively.

Between 1990 and 1992, the monetary authorities adopted a set of measures to strengthen banking supervision and promote the viability and soundness of the banking system. In 1990, then CBN issued the circular on capital adequacy which related banks' capital requirements to risk-weighted assets. It directed the banks to maintain a minimum of 7.25 per cent of risk-weighted assets as capital; to hold at least 50 per cent of the total components of capital in capital and reserves; and to maintain the ratio of capital to total risk-weighted assets at a minimum of 8 per cent from January, 1992. Similarly, the CBN issued in November, 1990 the Prudential Guidelines for licensed banks on income recognition and provisioning for non-performing credits to enhance standardisation and quality of financial reporting. Among others, the guidelines require all banks to

make adequate provisions for perceived losses based on portfolio classification so as to reflect their true financial positions. Complementing the capital adequacy requirements and prudential guidelines was the Statement of Accounting Standard No. 10 issued by the Nigerian Accounting Standards Board in co-operation with the monetary authorities to banks and non-bank financial institutions. The Statement was designed generally to ensure the accuracy, reliability and comparability of the financial statements of these institutions.

Some institutional changes were embarked upon not only to strengthen banking supervision, but also to enhance the efficiency and safety of the banking system. First was the establishment of the Nigeria Deposit Insurance Corporation (NDIC) charged with the responsibility for insuring bank deposits against bank failures and ensuring safe and sound banking practices through effective monitoring and supervision of the banks, in collaboration with the CBN. Given the large increase in the number of banks indicated earlier and the higher probability of bank failure, the coming into existence of the NDIC is intended to instill greater confidence in the banking system. Second was the series of actions by the CBN and NDIC to assist the distressed banks beset by serious problems of illiquidity, poor asset quality, capital erosion, poor management and technical insolvency. Such banks have been identified from time to time and subjected to special examinations. In a bid to safeguard their assets, Holding Actions are usually imposed on them, while the management of banks which fail to respond positively to official actions is taken over by the CBN in the interest of depositors, other creditors and the banking system as a whole.

Third and probably most significant institutional change since 1986 was the promulgation of three banking laws – the CBN Decree, No. 24 of 1991 and the Banks and Other Financial Institutions Decree (BOFID), No. 25 of 1991 which repealed the CBN Act, 1958 (as amended) and the Banking Decree, 1969 (as amended), respectively; and the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree of 1994. The new CBN Decree enlarges the powers of the CBN with regard to the maintenance of monetary stability and a sound financial system. In an attempt to stem the source of persistent excess liquidity, the Decree substantially reduces the size, relative to the Budget, of advances that the CBN may grant to the Federal Government in any one year from 25 per cent to $12^1/_2$ per cent. The Decree also contains provisions to facilitate the use of market-based instruments of monetary control. In addition, the Bank's powers to obtain data and other information from economic agents in the country and appropriate directives to financial institutions are strengthened and expanded in scope to plug the observed leakages in monetary management. The BOFID also effected changes in the regulations which could promote the development of the financial sector in a deregulated environment. The Decree contains the following important elements: (i) the centralisation of the functions of bank licensing, regulation and supervision in the CBN; (ii) provision for changes to be made to some aspects of the law without recourse to a new legislation; (iii) strengthening of the supervisory powers of the CBN regarding keeping of proper books of accounts by financial institutions, the control of distressed banks and winding-up of failed institutions; (iv) enlargement of the duties and responsibilities of directors and external auditors of banks; and (v) bringing under the regulatory/ supervisory purview of the CBN all non-bank financial institutions whose activities influence the economy in a significant way. The objective of the Failed Banks (Debt Recovery) and Financial Malpractices in Banks Decree is to bring to book those who

contributed to the failure of banks and to recover debts owed to such banks.

Other innovations were made with regard to the role of the public sector in the banking sector. The first was the Treasury Circular of May 26, 1989 which directed that all government deposit accounts should be kept with the CBN in order to prevent such accounts from discouraging healthy competition in savings mobilization and to check excess liquidity in the banking system. The second was the introduction, also in 1989, of the use of an auction-based system for treasury securities, the principal objective of which is the promotion of greater reliance on market factors in the determination of the yields on government debt instruments through market-determined interest rates and efficient management of the public debt. The third innovation was the decision by the Federal Government in 1990 to sell its shareholdings in some commercial and merchant banks thereby reverting such banks to private ownership as was the case before 1972.

VI. PERFORMANCE APPRAISAL OF MONETARY AND BANKING POLICIES

A review of monetary developments in the last decade shows that overall liquidity of the economy as measured by the end-year levels of broad money (M_2) grew rapidly. The rapid growth in M_2 reflected sharp increases in narrow money (M_1) which was the target variable. While (M_2) rose by 8.7 per cent against a target of 6.5 per cent in 1985, and recorded negative growth (-4.5 per cent) in 1986, it expanded in 1987 by 17.1 per cent which was slightly higher than the target of 11.8 per cent. The initial declaration and modest growth was in line with low inflation figures of 5.5, 5.4 and 10.4 per cent observed in 1985, 1986 and 1987, respectively. However, in 1988 money stock rose by 42.3 per cent following the reflationary package of that year. From 1989, excess liquidity in the economy had started to be a source of concern as the growth rates of M_1 deviated significantly from targets. Except in 1989 when the major factor responsible for the increase in money supply was rapid growth in net foreign assets, monetary expansion during the period was due to the increase in aggregate bank credit. Efforts made through policy changes and innovations succeeded only marginally in 1989 after which the broad money stock expanded rapidly. Although, the package of measures for monetary and banking management so far has had some salutory effects such as the stimulation of competition in the financial sector, greater efficiency in the allocation of resources, and keeping liquidity in the banking system from exploding further, they were unable to prevent excessive growth in credit and hence money stock, which was due largely to undue fiscal expansions. These developments, coupled with sluggish growth in output, could not generate adequate employment. Consequently, inflation persisted while the achievement of external balance remained elusive – all of which have posed greater challenges for the future. Similarly, measures taken to resolve the distress in the banking sector have not yielded the desired results because of the difficulty of restoring the confidence already lost in the system and the existence of some lingering constraints to the resolution measures.

VII. CONTEMPORARY ISSUES IN MONETARY AND BANKING POLICIES IN NIGERIA

I consider it appropriate, in a forum such as this, to identify, articulate and clarify some of

the leading issues in Monetary and Banking Policies in Nigeria. In doing so, I shall attempt to anticipate your questions and acknowledge your concerns.

First is the issue of policy implementation and performance. As indicated above, over the years, there has been persistent divergence between policy targets and actual performance. Moreover, macro-economic instability, as manifested in fiscal imbalances, exchange rate depreciation, and unduly high interest rates as well as financial sector distress, has prevailed. The problems are traceable to some measure of faulty strategy and poor implementation. With respect to monetary and banking policies, it should be stated that although the policy regime has been largely sound, implementation has been constrained by unduly high and persistent fiscal deficit, with the Central Bank being compelled to finance it. This undue reliance on high-powered money to meet budgetary gaps has been a major source of macro-economic instability.

Second, there is the problem of policy instability with all the adverse repercussion and negative signals it engenders. The question then is how do we ensure the sustainability of policy measures? For the sustainability of policy measures, the policy regime itself must be comprehensive, technically sound, credible and internally consistent. It should be the outcome of adequate consultation with relevant institutions and groups and must embody some social safety nets (poverty alleviation measures) and have some element of mass participation and involvement through social mobilisation. Furthermore, policies need a sound implementation strategy, including phasing and sequencing of measures, demonstrable political will and commitment, resolute pursuit of policy goals, and monitoring, review and modification (fine-tuning) of measures. Above all, there must be an enabling environment to enhance confidence and induce inflows to fill resource gaps and thereby give the policy measures a growth orientation. In other words, policy measures do need to achieve tangible positive results in good time to justify the sacrifices made and engender continued support for them otherwise implementation fatigue and policy backlash would ensue and prepare the ground for policy reversals and *volte face.* There is also the issue of distributive equity in terms of the equitable sharing of the burden of adjustment among different social groups.

Third, there is the controversial issue of liberalisation and deregulation. In this connection, I wish to stress that deregulation does not mean the absence of regulation. Properly considered, it is the deliberate, ordered process of removal or mitigation of regulations which are outdated and useless and tend to foster distortions, inefficiencies and competitive inequities. In this connection, it involves the introduction of new measures intended to enhance efficiency, safety and stability, for example prudential regulation and capital adequacy stipulations. Furthermore, even in a deregulated economy, there is need and scope for intervention by the authorities to ensure orderliness and the observance of legality as well as to give direction for the achievement of policy objectives. I assert that it is wrong to claim that the deregulation policy initiated under the auspices of the SAP had failed. It is more correct to say that what we have had was a failure to truly deregulate rather than a failure of deregulation.

Fourth, still on policy strategy, there is the debate over shock therapy versus gradualism. Shock therapy designed as a quick surgical operation or "quantum jump" to correct for massive slippages in policy has its attractions. However, in our experience it has been a disaster because of the absence of supportive, complementary measures. Gradualism, with some measure of sequencing of policy measures, appears to do better in our type of environment.

Fifth, it is perhaps relevant to deal with the fortunes of the Naira in the Foreign Exchange Market since 1986. Exchange rate developments have been a matter of interest and no little concern. The concern has to do with the persistent depreciation of the exchange rate with all its adverse repercussions. Of course, we in the Central Bank share this concern and a major policy goal is the achievement of exchange rate stability and restoration of the value of the Naira. However, it should be stated that the exchange rate reflects the condition of the economy and that the persistent depreciation of the Naira could be explained in terms of the country's poor economic performance. For instance, if the fiscal deficit has been kept to no more than about 2.5% of the GDP as envisaged under the SAP, the exchange rate would by now be about N5.00 to $1.00. It should also be stressed that the Naira has been somewhat undervalued because of inflationary pressures and speculative attacks. Nevertheless, it is possible to design and implement a rescue package for the Naira through a comprehensive framework involving demand management measures, exchange rate unification, supply side initiatives and complementary action. The package should not only be sound on paper but also be backed by the political will to resolutely implement it. In the final analysis, the economy needs to grow at a faster rate; exports must expand and become more diversified to enhance foreign exchange receipts; and the country must reduce its import dependency through a credible regime of policy incentives and sanctions. I regret to say that there is no other way, no short cuts, no "quick fixes"!

Sixth, I now wish to briefly discuss the issue of financial sector distress. In spite of the significant achievements made in the financial services industry since 1986 in terms of the growth in the number of market participants, types of institutions, volume of operations and number of products on offer, the industry is steeped in a deepening crisis of confidence. The crisis has manifested in the large and increasing number of technically-insolvent and, in some cases, failed institutions; liquidity problems; defaults in meeting depositor/creditor obligations; large portfolio of non-performing credits; and shareholder/Boardroom conflicts.

This state of affairs has arisen from the convergence of many negative factors including the following: macro-economic and policy instability; policy-induced shocks; economic recession; meddlesome interference by shareholders, both private and public; insider dealing and abuses; gross mismanagement; frauds; undue proliferation of market intermediaries; and inadequacy of supervisory sanctions.

The restoration of confidence and viability in the financial system requires a comprehensive framework, encompassing the achievement of an enabling macro-economic and policy environment; more robust supervisory intervention in distressed institutions; heightened depositors awareness; co-ordination of regulatory activity; the promotion of self regulation in aid of safe and sound banking practices; increased professionalism and ethical conduct by operators; improved customer services; more stringent regime of sanctions for dealing with offending institutions and officers; and the political will to close down institutions which had failed beyond redemption. I should stress the imperative of managed i.e. orderly, exit of failed financial institutions. An effective exit policy would enhance the health and efficiency of the system while engendering financial discipline and accountability. The task of salvaging the industry is a collaborative endeavour involving shared responsibilities and the burden among Government, the regulatory authorities, shareholders, directors, depositors and creditors. However, recently, Government has through its various functionaries, declared that it

would not provide any financial support in aid of distressed banks. In the circumstances, market-based solutions would become increasingly relevant.

I should stress that while our goal as bank regulators/supervisors is to enhance the safety and stability of the banking system and the soundness and viability of individual banks our efforts cannot guarantee that there would be no bank failure. Indeed, badly managed banks would fail in spite of the best endeavours of bank supervisors.

Seventh is the issue of the capacity of the CBN to effectively regulate and supervise the banking system. Enhancing in-house expertise and supervisory capacity is a matter that has been seriously engaging the attention of the Bank especially in recent years. The initiatives taken include reforms in the banking law; training of staff and recruitment of seasoned professionals; computerisation; collaboration with other regulatory agencies, and reinforcing the regime of sanctions to make it more penal. In recent years, the Central Bank and the NDIC have been severely criticised for not doing enough to protect the interest of depositors and in dealing with distressed institutions. While I acknowledge shortcomings and accept that bank supervisors could do better, I consider it unfair that they should be blamed for the crisis in the system. This is because the prevailing unsatisfactory state of affairs has arisen from various factors beyond the control of the CBN and the NDIC.

The alleged ineffectiveness of bank supervisors should be seen in the context of macro-economic and policy instability; policy shocks; economic recession; systemic distortion; unsafe and unsound practices of some market operators and their increasing lack of transparency; the indifference or negligence of some directors and the shareholders; the gullibility and greed of investors who fall easy prey to charlatans; legal loopholes and constraints; and the generalised societal indiscipline. In such a situation of collective guilt, it is uncharitable to blame the regulatory authorities for the prevailing unsatisfactory state of affairs. It should, therefore, be stressed that the regulatory agencies cannot alone effectively shoulder the task of sanitising the financial services industry. Shareholders and Boards of Directors of financial institutions; depositors; trade and professional associations; law enforcement agents; the courts etc., all have a role to play.

The **Eighth** issue has to do with CBN autonomy. It should be noted that in recent years there has been sustained global movement towards greater autonomy of central banks. This development has arisen from the failure of fiscal policy as most Governments, for political expediency, embarked on undue fiscal expansion resulting in large and entrenched fiscal deficits which engendered serious macro-economic instability. In those circumstances, it was recognised that only central banks, endowed with the required independence, that could re-establish domestic price stability without which there would be no resumption of sustainable economic growth. Moreover, empirical evidence and country experiences, have established some measure of positive correlation between central bank independence and economic performance e.g. West Germany, U.S.A., Switzerland, New Zealand and Canada. Exceptions such as Japan are explained largely by cultural factors.

In the context of Nigeria, I wish to stress that Central Bank autonomy does not mean independence of Government or that the Central Bank is above the law or unaccountable or is free to award contracts of whatever size as is often suggested by critics. Properly considered, CBN autonomy should be construed as autonomy within Government. What are required are a mandate (e.g. the maintenance of price stability

i.e. anti-inflation mandate as in New Zealand) to be given to the Bank by the Executive/ Legislative authorities; the legal and operational autonomy required for the achievement of that mandate (so-called instrument independence); freedom from political influence and pressures; and accountability of the Bank to the Nigerian people for its performance through periodic reports and reviews.

Ninth, I consider it appropriate to lift my gaze and speculate on the future direction and prospects for monetary and banking policies. Experience has taught us that controls are a useless bureaucratic exercise and that market-based arrangements which mediate the collective wisdom and preferences are superior in terms of allocative efficiency. The prognosis, therefore, is that subject to the right environment of fiscal viability and rectitude, monetary policy would rely increasingly on market-based indirect techniques. In that context, monetary policy would be conducted in a more sophisticated, confident and efficient manner. Policy adjustment would be in the form of fine-tuning of measures rather than cataclysmic or episodic path-finding movements. Above all. monetary policy performance would be consistent with targets and optimal rather than disoptimal. However, the greatest challenge now is to achieve macro-economic stability without which there could be no economic recovery and resumption of sustainable growth. Let me conclude on the optimistic note that the existing policy regime, with some fine-tuning to reflect more interest rate realism, and resolute implementation, has the potential for restoring macro-economic stability. It is a prospect which all concerned must work hard for.