AN ASSESSMENT OF MONETARY POLICY AS REGULATORY TOOL FOR ECONOMIC DEVELOPMENT IN NIGERIA

BY

LABARI JEROME MUTUAH
MBA/ADMIN/39749/04-05
(GO4BAMF 7120)

BEING A PROJECT SUBMITTED TO THE POSTGRADUATE SCHOOL IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA) OF AHMADU BELLO UNIVERSITY, ZARIA.

DEPARTMENT OF BUSINESS ADMINISTRATION,
FACULTY OF ADMINISTRATION
AHMADU BELLO UNIVERSITY,
ZARIA.

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CERTIFICATION

This is to certify that this project titled "An Assessment of Monetary Policy as Regulatory Tool for Economic Development in Nigeria" By Labari Jerome Mutuah meets the regulations governing the award of Master in Business Administration (MBA) of Ahmadu Bello University, Zaria and it is therefore approved for its contributions to knowledge, and literary presentation.

____________________	________	_______
Dr. A.B. Akpan Chairman, Supervisory Committee	Signature	Date
____________________	________	_______
Dr. M.N. Maiturare Head of Department	Signature	Date
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External Examiner	Signature	Date
____________________	________	_______
Dean, Postgraduate School	Signature	Date

DEDICATION

The project is dedicated to my beloved wife Mrs. Ladi J. Mutuah and my children Miss E. Yinu Mutuah, Master Samson, Joseph and Master Jerry Mutuah Junior for their love and understanding.

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My greatest gratitude goes to Almighty God who spared my life and gave me strength and wisdom to complete this course successfully.

A big thank you also goes to my Supervisor in Person of Dr. A.B. Akpan who despite this crowded and heavy responsibilities found time to supervise my project made criticism, I really appreciate it and God bless.

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Also I will want to express my condolence to the Families of the Belleview Aircraft disasters victims of 22nd October 2005, may their souls rest in perfect peace. Amen.

Special acknowledgement goes to everyone that contributed toward my successful completed of my programme of study even though it is not possible to mention all the names – I say a big thank you. You are all bundles of inspiration and I remain grateful. God bless you all.

ABSTRACT

The responsibility of maintaining a sound financial structure in the economy involves on the Central Bank. The Central Bank occupies a unique position in the financial system of the country. It has revolved a number of enduring relationship with commercial banks and the banking sub sector comprising mainly merchant and development banks and the non-bank sector which is made up of a wide range of organizations operation as regulators, facilitators and investors such as the Security and Exchange Commission (SEC), the stock exchange, stock brokers, insurance companies, National Provident funds etc.

After the formation of monetary policy and the acceptance of this by the government through its budgetary pronouncement, the Central Bank organizes the execution of the policies. The CBN gives the directive to financial institutions which may take the form of monetary policy circular issued by the governor of the Central Bank as the beginning of every financial year and subsequently supplemented by some such as exchange control circular as circumstance may demand.

As part of its responsibility for promoting a sound banking structure, the monetary policy ensure that the banking industry operates strictly within the provision of the law and regulations laid down. The

CBN also processes the statutory power to deal with those banks that have persistently failed to observe the regulatory issued by the CBN.

Responding to the needs of the ever changing economy, the Central Bank realizing that the application of its traditional instrument of control of the banking industry has not produced the expected goal resorted to direct control through monetary policy guidelines, this aspect to its control started in 1969 after some year of experience of its attempt to control the baking industry.

The traditional function to the Central Bank include the issue of legal tender currency, formulation and execution of monetary policies, maintenance of external reserves so as to safeguard the international value of the country's currency, the promotion of monetary stability and a sound financial structure in the country as well as bankers and financial adviser to the federal government.

In view of the economic recovery programme, the Central Bank plays the role of implementing modalities for exchange rate policy, foreign exchange management, external reforms the Central Bank also offers advise to government in areas such as fiscal, external trade and other public sector policies.

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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The monetary policy of a country is an important aspect of its overall economic policy. Monetary policy is addressed to regulating the volume, direction and price of money supply and credit in the economy, in the hope that change in money supply and credit will produce some desired changes in other economic variable like the price level, employment, National income, savings and investment, monetary policies instrument therefore would hopefully contribute to economic growth by adjusting money supply to the needs of growth by directing the flow of funds in the required channels and by providing institutional facilities for credit in specific field of economic activities. Appropriate monetary policies utilizes a number of instruments which when efficiently used could help stimulate economic growth. These tools or instruments tools include discount rate, reserve ratio, moral suasion, open market operation, special deposit etc. the use of any or a combination of these depends on the overall economic objectives that are being pursued at that particular moment or time.

Before the establishment of the Central Bank of Nigeria in 1958, monetary policy were largely conducted by the West African Currency Board even though it had no discretionary power over the total amount of money and could not perform any banking function. The establishment of monetary institution such as the Central Bank of Nigeria was quite appropriate to enable it to contribute to the country's economic development[1]. This was observed by Ojo A.T. and his colleagues. Following the .B. Loyne's report, the Central Bank of Nigeria was established by a Act of parliament known as the Central Bank Act to perform traditional banking function and serve as the pivoted of national functional institution.

Since the inception of the Central Bank of Nigeria, it is a well known fact that implementation of the Federal Government Monetary Policy objectives has been a crucial problem. Very sound and praise-worthy policies have been formulated in respect to many issue in the country but their execution had remain the problematic area. The year 1988 – 1990 had been a prescriptive and restrictive one in terms of Federal Government Monetary Policies. The country was fully mortgaged to the external creditor like the IMF, World Bank, London and Paris Club to mention but a few. The mortgaged was done under the canopy of the so-called package of Structural Adjustment Programme (SAP) through the instruments of Second Tiers Foreign Exchange Market (STFEM).

1.2 Statement of the Problem

Over the decade, precisely since the time of the so called political independence of this country, the economy of the country has been with serious problems. A number of factors may be responsible for these problems which range from instability in the political leadership as every regime brings about it policy in terms of monetary regulation. Another problem was lack of competent, dedicated and honest leadership to mention but few. The economic situation has become so severe, unbearable as manifested by the high inflationary rate rose from 5.4% in 1986 to 57.2 in 1993. The government did not succeed in improving the inflationary rate and can the availability of consumer goods either or to ensure stability of prices of goods and services. The reasons for this malfunction in the economy was due to ineffective monetary policies.

1.3 Objective of the Study

Monetary policies has been an issue of great concern the various successive government of this country. The issue is even more serious now at least with the introduction of the so called Structural Adjustment Programme (SAP), Second Tier Foreign Exchange Market (SFEM), Open Market Operation (OMO) etc which compounded the economic problems and recent monetary policies of the Federal Government are refulgent to the yearnings and aspiration of the people.

This study therefore, is hoped to contribute immensely to the following:

1. It will contribute to the advancement of knowledge especially in the field of academics.
2. It will also help monetary authorities in the quest for more viable and effective monetary policies in this country.

1.4 Scope and Limitations of the Study

This study seeks to assess the monetary policies as a regulatory tool for economic development in Nigeria. The limitation of this study is found in the interpretation of the years. Some of the effects of the policy do not emerge immediately within that year but takes sometimes or certain longer period before it manifest. This makes it relatively difficult to assess critically how the objectives get for each year have been achieved within that year. Some of the impacts can be felt after some years. This seriously constitute a limitation to the study.

1.5 Research Methodology

In carrying out this research both primary and secondary sources of materials (data) would be consulted. The information which would be obtain from the primary sources of information are various publication of the Central Bank of Nigeria (CBN), some of which are in the Research Department of the Central Bank of Nigeria (CBN).

Other sources of secondary data include textbook, journals, Guardian financial weekly, Business Time and the Reporter.

1.6 Significance of the Study

This study shows the importance of the monetary policies of the Central Bank as a powerful weapon which can be used as control the economy. Hence economic development can be achieved if the monetary policy can be effectively monitored and directed as appropriate. At the end of this assessment, the result of the study will provide useful suggestions to rectify identified areas of problems.

I will equally be helpful and will contribute to knowledge and the further research on monetary policy.

1.7 Hypothesis

The following hypothesis would be tested in order to ascertain or disagree with such policies.

1. That adequate publicity are not given for such policies to be accepted adequately by the generality of the people.
2. That such policies do not give immediate results.
3. That such policies are not adequately implemented to the later.

1.8 Plan of the Study

The entire research project consists of five chapters. Chapter one is the general introduction which consist background of the study, statement of the problem, aims, scope and limitation of the study, research methodology, significance of the study, hypothesis, plan of the study and definition of major concepts.

Chapter two has the literature review and theoretical framework.

The third chapter is the historical background, function and objective of Central Bank of Nigeria, Organizational Structure and Monetary and finance stances.

The fourth chapter is the data presentation and analysis area. Here monetary policy are assessed over the years and brought to limelight. While the fifth chapter is the summary conclusion and recommendation.

1.9 Definition of Major Concepts

Assessment	-	By Assessment it means to judge or decide the amount value, quality or importance of; to Evaluate Certain activities or action.
Central Bank	-	Central Bank of Nigeria is the apex regulation authority of the financial system in the country. It regulate and supervision of the banking sector and licensing finance companies which hitherto operated outside the regulatory.
Monetary Policy	-	This said to be government action on money. How it regulates funds and what it choose to do.
Policy Target	-	It is set objectives laid down to be achieved with a particular period or year.

Public Policy	-	Public Policy is a problem solving process. Hence it is what government chooses to do or not to do.
Policy maker	-	A single person who is among those that make a policy is a policy maker. A single person does not make a policy.
Policy legitimization	-	It is the articulation of a policy proposed by legislation for consideration as adaptation.

REFERENCES

Ojo, A.T.; Adewunmi, W. Banking and Finance in Nigeria, Graham Burn, U.K., 1982 P. 23 – 24.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 INTRODUCTION

This chapter will contain the definitive nature of monetary policy by various authors and monetary authorities and explanation of terms which are used in the project writing, the operation of money market, objective policy.

Tools of monetary policy, relationship and conflict between monetary objectives and evaluation of monetary policy in Nigeria are also included in this chapter.

2.2 DEFINITION OF MONETARY POLICY

According to Utum Wai (1959) monetary policy can be defined as a course of action taken by public authorities (Central Banks, Ministries of Finance, Exchange Authorities) and financial intermediaries (Deposit Banks, Discount Companies and other specialist banks, Insurance Companies etc) in pursuance of certain objectives concerning monetary phenomena which relates to the impact of changes in them and economic activities in general.

Nwankwo (1974) defined monetary policy as the measure or a combination of measures designed to influence or regulate the volume, price and direction of money and credit to achieve rationally stipulated objective.

Similarly, Uzoaga (1982) viewed monetary policy as the management of the expansion and contraction of the volume of money in circulation for the specific purpose of achieving , certain declared national objective. Farmess (1975) also sees monetary policy as "one which aims at influencing economic activities by variation in the supply of money in the availability of credit or interest rates". While Okaloku (1979) sees it as deliberate action on the part of monetary authority as regard to the cost, i.e. interest rate, for achievement of certain set of economic objectives.

3.2.1_ Explanation of Terms

Monetary Policy

Deregulation

Debt

Objectives

The above terms have been widely used in this project and given below is an explanation / interpretation of the terms.

(i) Monetary Policy:

Refers to the credit control measures adopted by the Central Bank of a country. It is an instrument for achieving the objectives of macro economic policy.

(ii) Deregulation:

A better understanding of the need for deregulation should start with the concept of regulation. Regulation in its broadest sense, refers to all the controls which the government imposes on the economy in general and the banking system in particular.

Economic deregulation, which involves appropriate realignment in fiscal monetary trade, pricing and exchange rate policies, was viewed as a tool for reducing undue government intervention in economic activities and providing the relevant structure of incentives.

(iii) Debt:

If the nations expenditure exceeds its income the differences must be made up by borrowing, the amount borrowed is called debt.

(iv) Objectives:

Objectives are those ends which an organization seeks to achieve by its operations throughout its existence. A variety of different objectives are pressured by business organizations. Some example are continuity of profit, efficiency, employee satisfaction, development of quality products or services for customers and clients, good corporate citizenship and social responsibility, and market leadership.

2.3 OPERATION OF MONEY MARKET

A money market can be defined as a market consisting of financial institutions and other dealers in short-term money and credit who either want to lead or borrow money.

It is important to note that the money market in Nigeria is not located in any fixed or particular place or building where money is bought and sold. It is a term which embraces all institution that handle purchase, sale and transfer of short-term money and credit instruments. Money market activities can be carried out at a specified area or street as in the case of wall street, in New York or Command Street in London which is synonymous with London money market. There are certain basic conditions which must be met before a money market can function effectively.

1. There must be a Central Bank capable and willing to act as "lender of last resort". Where such a condition exists, it enables the banking system to operate to lower levels of liquidity, making full use of available resources.
2. There must be an intergrated structure of financial organization holding a variety of assets with differing liquidity levels and profitability.

2.3.1 Development of the Money Market

The Central Bank of Nigeria initiated the money market in Nigeria with the issue of the First batch of treasury bills in April 1960. The market has experience a phenomenal growth since that date with the addition of a number of traditional short-term money market instruments.

i) Treasury bills:

This was first issued in 1960 treasury bills are 91 days maturity short-term debt instruments issued to raise finance for the Federal Government. They are also used as an instrument of monetary policy by the C.B.N. The CBN can use it particularly in execution of open market operations to mop up excess liquidity of purchasing power in the economy.

ii) <u>Call Money:</u>

The call money scheme was introduced in 1963. Under this scheme, the Commercial Banks and other participating financial institutions kept their temporary surplus cash with the Central Bank of Nigeria which them invested the funds in short-term money market instruments, which at that time were only treasury bills.

iii) <u>Treasury Certificates:</u>

Treasury certificates were introduced in 1968 mainly to fill the gap left by the termination of produce on commercial bills. Treasury certificates have tenure of 1 – 2 years. They are similar to treasury bills in all ways with the exception of tenure.

These instrument facilitated the development of a local money market leading to localization of credit base. Between 1962 – 68 the authorities consciously worked toward the development of the money market. The policy objectives shifted again after 1972 to the need to allow the money market to grow, as the government demand for money market funds had reduced considerably as a result of an increasing flow of oil revenues. To create an avenue for banks to continue to invest their surplus funds locally, other money market instruments were created and introduced in March, 1975.

iv) Certificates of Deposit:

These are in two categories; negotiable certificates of Deposit (NCD), and Non-Negotiable Certificate of Deposit (NNCD). They are inter-banking instruments with maturity dates ranging from 3 to 36 months.

v) Bankers Units Fund:

This was introduced into the market in September 1975. It is a scheme under which banks and other financial institutions can invest parts of their excess liquidity resources. Participants invest in multiples of N10,000 while the CBN in turn invest the pooled fund in government stocks. A major incentive in this scheme is that the invested funds are repayable on demand in a whole or in part, provided withdrawals are in multiples of N10,000. Interest is payable on the investment. This instrument was designed to channel commercial and Merchant Banks and other financial institutions surplus funds into Federal Government Stocks.

2.4 OBJECTIVES OF MONETARY POLICY IN NIGERIA

Most of the monetary policies of industrial market economies are applicable to developing countries. But, they have different objectives to achieve. Below are some of the objectives:

1. Creating confidence in the currency, especially confidence in paper notes.
2. Stabilization of internal price here and growth policy for factor incomes compatible with the stable price level for goods.
3. Control of the supply of money to stabilize the domestic price level.
4. Developing short-term medium and long term capital market for fixed interest and equity securities.
5. Reducing lender and borrowers risk and uncertainties, which are incomparably higher in developing countries.
6. Raising the propensity to save even among the largest income groups therefore eliminating chronic indebtedness.
7. Promoting creative risk-bearing i.e., promoting additional productive real investment versus ostentation to ensures hoarding or purely monetary investments.
8. Intergrating the segregated economic behaviour system.

9. Creating new monetary institutions to promote development such as deposit insurance, credit insurance, hire purchase, past office, checking accounts and mobile banks.
10. Auditing the balancing of external payment and thereby aiding the stabilization of the foreign exchange rate.
11. Contributing to a reduction of visible and disorganized employment through creation of jobs via investment.
12. Manipulating the money capital movements in and out of the country in the interest of balancing the external accounts and accelerating development.

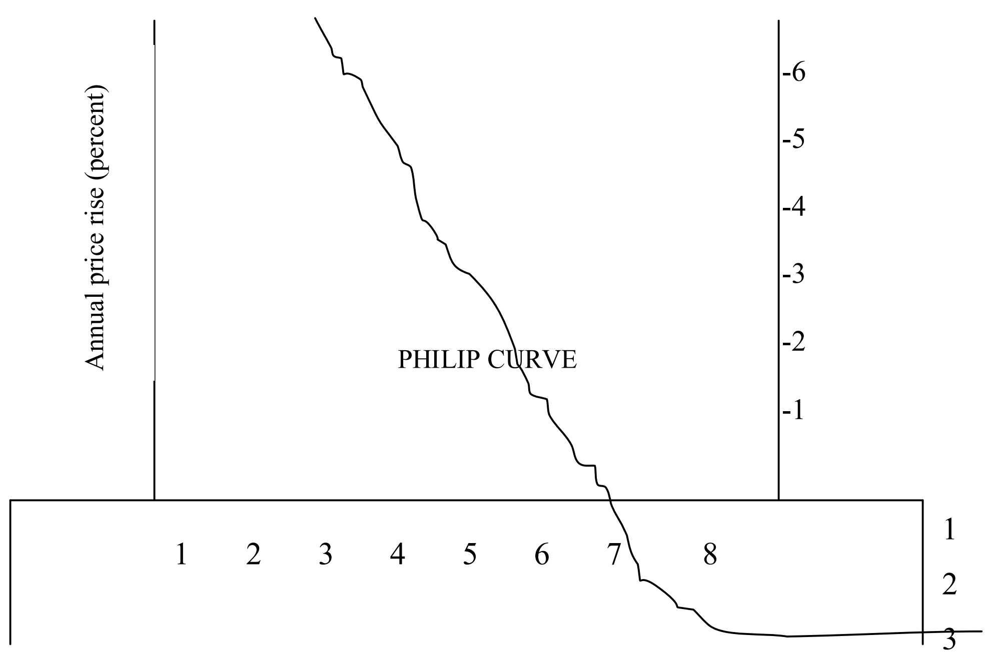
Flight of capital can effectively prevented only by high profitability of investment, profitability of economic progress, confidence in the currency and capital security comparable to that existing in industrialized countries.

2.5 RELATIONSHIP AND CONFLICT BETWEEN MONETARY POLICY OBJECTIVES

The nature of macro-economic problem is such that there is bound to be a conflict of the monetary authorities try to achieve various objectives simultaneously. This makes the task of achieving macro-economic stability more difficult as a combination of instruments that will achieve "optimal" combination of objectives have to be selected.

However, according to Uzonga (1981), "Certain economic objectives are naturally re-inforcing. For instance, balance payment equilibrium and the maintenance of minimum inflation. Infact, the attainment of the latter will assist in the achievement of the former. Anti-inflationary measures involving persistent dampening of aggregate demand of inhibit investment and adversely affect the rate of economic growth. Therefore, persistent pursuit of one of the objectives may result in failure with respect to the other.

TRADE OFF BETWEEN INFLATION



The relationship between the price level stability and full employment also look incompatible. Philip A.W. (1958) used the Philips curve to show a trade off that is inverse and non-linear between these two macro-economic variables.

Harritz (1968) observed that all the three goods i.e, an adequate rate of economic growth, high levels of employment and a reasonable price level stability can be achieved simultaneously and that they are fundamentally compatible.

2.6 TOOLS OF MONETARY POLICY IN NIGERIA

The institutions that make the monetary authority include the Central Bank, Ministry of Finance and the Treasury. These institutions play a vital role in shaping monetary policy of any nation.

In Nigeria context, several types of financial institutions are allowed to operate and they can be differentiated from others based on the nature of assets and liabilities. The tools of monetary management can be classified under two headings: Quantitative and qualitative tools. Quantitative tools such as reserve equipments, discount rates, open market operations and sometimes interest ceiling on deposit. Qualitative of selective tools include moral suasion, selective credit control are indirect monetary measures. We shall briefly examine each tool of monetary measures below:

2.6.1 <u>Open Market Operations</u>

The Central Bank can influence Commercial Banks reserves and therefore the supply of money through its open market operations. This may involve the purchase by the Central bank of Government Securities from the Commercial Banks and the non-bank public. The reverse is the case when the Central Bank buys Government Securities from the Commercial Banks and the non-Bank public. Thus a purchase of securities by the Central Bank is indicative of a liberal monetary policy, sale indicates a tight monetary policy. Open market operations can be made a continuous activity and in this respect they have the advantage that unlike other policy instruments they do not have an announcement effect.

2.6.2 <u>Discount Rate</u>

The discount rate determines the cost of which commercial banks can borrow from the Central Bank as ‘lender of last resort”. Unlike the two earlier instruments or policy tools, the discount rate does not directly affect the reserves of Commercial Banks. Its direct impact is on the cost of credit.

The price is expressed in interest rate and referred to as the discount rate. Changes in the discount rate are usually associated with an increase or a decrease in Central bank credit to the Commercial Banks. The Central Bank is able to use the discount rate because of its position as the lender of last resort. An increase in the discount rate means that the Commercial Banks will also have to rise their own interest rates, where it is allowed in order to maintain their profit margin.

2.6.3 <u>MORAL SUASION:</u>

Moral suasion is simply a process by which the monetary authorities, make known to Commercial Bank officials through informal discussions, the direction in which they wish monetary policy to proceed and the contribution which is expected on the part of the Commercial Banks.

2.6.4 Control of Bank Liquidity

The emphasis in controlling bank liquidity in Nigeria is rightly on the direct method. This is put into effect through the variable liquid assets ratio (liquidity ratio), variable cash ratio, supplementary securities.

By the devices of the variable liquidity ratio, the Central bank is empowered to vary the liquidity ratio of assets as required, specify the minimum, amount of liquid assets, expressed as a ratio of total deposit liabilities, which commercial banks are to maintain.

The Central Bank's Power to call for special deposits from the commercial banks has similar blunt effect on Commercial Bank liquidity as the cash ratio in that such funds are generally frozen in the Central Bank and therefore, unavailable for credit creation. But special deposit differ in one or two important respect from cash reserve ratio.

The power to issue stabilization securities also gives the Central Bank a direct instrument for controlling commercial bank liquidity and consequently their credit operations. The CBN can issue and place with the banks operating in Nigeria any amount of such securities and can redeem them at will. While sales of these securities to the Bank reduce their liquidity, purchases from them achieve the reverse.

2.6.5 Direct Central Bank Credit

Credit ceiling and selective control are the principal means of directly influencing bank credit operations in Nigeria. Another variant of this instrument is the power to prescribe minimum ratio of loans and advances which the commercial banks should grant to indigenous persons and also the requirement that loan application exceeding a specified amount should be submitted by banks to the central bank for approval.

2.6.6. Credit Ceiling

A restrictive credit policy was adopted in Nigeria at the inception of Structural Adjustment Programme to control excessive expansion in money supply and demand for foreign exchange rate stability and improvement in the balance of payment.

As a result of non compliance by some banks, the aggregate performance by banks has been less satisfactory inspite of the stiff penalties imposed by the Central Bank of Nigeria.

2.6.7 Selective Controls

Selective credit control is very important in countries that have considerable control planning and supervision by the government.

The commercial banks in Nigeria have been required from 1980 to lend a minimum of 16 percent of their aggregate loans and advances to small-scale wholly indigenous businesses. The banks compliance with these requirements was very poor until still penalties were imposed for non-compliance in January 1987.

2.7 EVALUATION OF MONETARY POLICY IN NIGERIA.

The evaluation of monetary policy in Nigeria can be traced back to the West African Currency Board which was established in 1912.

The Central Bank of Nigeria at its inception behaved as a "national currency board". However with the introduction of a federal treasury bill issue from April 1960, the cash base for a "pyramid of money" was enlarged because commercial banks were able to re-discount these bills.

Infact, 1959 was considered a very crucial period in the analysis of the monetary policy in Nigeria. This period market the establishment of the CBN. The first phase of the Central Bank Monetary Policy from 1959 to 1970 was dominated by the following objectives. The attainment of balance of payment equilibrium regulating the banking system in the country, maintenance of adequate level of external reserve, the introduction of new currency to replace the West African Board notes and coins.

The second phase of the monetary policy was the period immediately after civil war i.e, 1970 – 1974. The monetary objective spell out the second national development plan which emphasized reconstruction and development of Nigeria as a united, strong and self-reliance.

The third phase of the evaluation of monetary policy (1980 – 1984) was basically aimed at regulating interest rate, stimulating domestic production, reduce rate of inflation in the economy, mobilized increased domestic and financial resources.

The fourth phase 1983 – 1992 covered by the present administration, in this phase, the monetary objectives were directed towards, trade liberalization, commercialization and privatization, deregulation of interest rates removal of oil subsidy etc.

2.8 CONCLUSION

The literature review which contains definition, explanation of terms, objectives of monetary policy, operation of money market, tools of monetary policy and evaluation of monetary policy in Nigeria has portrayed the procedure under which Central Bank of Nigeria perform its function in order to monitor the economy of the nation.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 RESEARCH METHOD

Research method is the most important aspect of this study because the success of failure of this study to a large extends depends on the effectiveness of the method.

The research method can be classified as follows:

i. Historical Research method
ii. Descriptive Research method
iii. Experimental Research method
iv. Survey Research method

Historical Research Method

This type of research seeks to answer the question “what wa” in the researcher examine available records in order to arrived at a conclusion on how past events affects the extend that it gives us information about past even or nation which may provide useful information to guide present day action.

Experimental Research Method

This is the must scientifically sophisticated research method and the purpose of experimental is to identify the conditions underlying the occurrence of a given phenomenon.

Experimental method is essential of scientific steps. They are out line as follows:

i. Selecting and defining the problem

ii. Drawing up the experimental design

iii. Defining the population

iv. Conducting the study

v. Analysis and interpretation of the result

vi. Drawing up the conclusion

vii. Reporting the result

Survey Research method

Survey research method deals with the study of both large and small sample of selected population to discover its relative incidence, distribution and inter-relation of sociological variables.

3.2 SOURCE OF DATA COLLECTION

Data for this study were collected through the primary and secondary source.

Primary Data:

Data that are expressed collected for a particular purpose are referred to as primary. The method of obtaining information from primary data sources used by the researcher is the questionnaire. Questionnaire is a list of question to be answered by respondent to get factor information about a subject matter.

Secondary Data:

Secondary data re those that have been published and in ready form for usage. The secondary data for this were essential source from newspaper, periodical journals and other national dailies, weekly or quarterly publications. Data were also obtained from that books written on Nigeria's debt management and other related subject or billion, series and Annual Reports and statement of Account of Central Bank of Nigeria.

3.3 DATA ANALYSIS TECHNIQUES

In addition to tabulation and classification of data, the researcher has to treat the data statistically; the sample information of this study is used in deciding between two (2) complementary causes of action.

For the purpose of testing the hypothesis formulated in section 5 of chapter 1, chi square test has been chosen because accurate statistic treatment technique.

This chapter discusses specifically the various method and procedures there were adopted from this research work. The population was described; the way in which the data were collected from the research work was analysed. The method of collecting data was decided into primary and secondary sources.

3.4 HISTORICAL BACKGROUND OF CENTRAL BANK OF NIGERIA (C.B.N.)

In 1912, The West African Currency Board (WACB) was an outcome of the recommendation of the colonial government and in 1960, the government of Nigeria after independences sow the need for establishment of a central monetary authority, as a result the Central Bank of Nigeria was established 1st July, 1959 with initial capital of N3 million (CBN) briefly series No (92/02 July 1991, pp. 1-2). The debate for and against the establishment of 5 Central Bank of Nigeria had gone for a decade before the promulgation of the CBN in 1948 and followed subsequently by other studies as the Trevor report (1951). Power (1951)

Sand (1952), Fisher (1953), the IBRD (1953), Nigeria and Bowan (1954), however, it was the acceptance of the report of the layness study of 1956. Published in 1957 that hated the debate and led to the establishment of Central Bank of Nigeria (Ojo, Adequame Op.cit. P. 23).

3.5 OBJECTIVE AND FUNCTION OF THE C.B.N

The major objectives of the CBN, as currently defined by the Central Bank of Nigeria Decree No. 24 of 1991 which supercedes the Central Bank of Nigeria Act of 1958, remain the same specifically the primary objective are:

To issue legal Tender currency in Nigeria, maintain the international value of the ledger tender, currency, promote monetary stability and a second financial system, as well as act as banker an financial adviser to the Federal Government and bankers to banks".

The CBN undertakes certain functions which include:

Currency Issue and Distribution

The bank's function of currency issue which involves distribution; sate custody of stocks and managements of orders constitutes very important part of the day to day management of Nigeria economy. The bank is the only bank that issues currency in the country. The bank notes and coin are commissioned for printing and minting by Nigerian security printing and minting company (NSPMC).

Banker to other Banks

The CBN has the statutory functions of acting as banker to the other banks in and outside Nigeria as specified under section 37 and 38 of CBN Decree No. 24 of 1991. The purpose is to promote and sustain reasonable banking service for the public and insure high standard of conduct and profession in banking activities.

Banker to the Government

The CBN undertakes most of the Federal Government banking business in and outside the country. The bank also provide banking services to the state and local government as corporation established by the government.

Foreign Exchange Management

The CBN monitors the utilization of scarce foreign exchange age and disbursement are in conformity with Nigeria economic priorities and with in the foreign exchange budget. Foreign exchange management to build up reserves, ensure stable value of the naira as well as payment of import and other services.

CHAPTER FOUR

4.0 DATA PRESENTATION AND ANALYSIS

4.1 INTRODUCTION

This chapter contains the practical and theoretical framework of the subject matter. Infact it addresses the fundamental issues as regards the monetary policy operations by the Central Bank of Nigeria i.e., introduction the application of monetary in Nigeria, the effect of foreign debt on the business activities in Nigeria, the importance of bank credit to business enterprises, business analysis, the effectiveness and limitation of monetary policy in Nigeria and finally conclusion.

4.2 THE APPLICATION OF TOOLS OF MONETARY POLICY FROM 1959 TO 1990

In pursuance of economic objectives, such as full employment, price stability, economic growth and balance of payment equilibrium, though these objectives have been mentioned in several places in this project, it is so because the objectives and methods applicable are the care of the subject matter.

For the prepare of this project, the phases of monetary policy in Nigeria are show below:-

Phase I	:	1959 – 1970
Phase II	:	1971 – 1979
Phase III	:	1980 – 1984
Phase IV	:	1985 – 1990

4.2.1 PHASE I 1959 - 1970

this phase is considered a very crucial period in the historical analysis of the monetary policy in Nigeria. This period marked the establishment of the CBN in 1959, the attainment of balance of payment equilibrium between 1964 and 1966, and the outbreak of the civil war, which lasted from mid 1967 until the beginning of 1970.

One of the unique characteristics of this phase was the outbreak of the civil war as a result of which the economy was considered “the war economy”. There was high rate of inflation and the government had to equip the central bank with additional weapon of monetary control to enable it take care of the situation. This was contained in the CBN Act amendment number 3 (Decree No 50) of 18th September 1968 stating the level of minimum ratios and discount commercial banks must take to indigenes, the imposition of credit ceilings, and the approval of commercial loans of certain sizes.

4.2.2. PHASE ii 1971 - 1979

The end of the civil war in 1970 triggered the second National Development Plan in 1970 – 1974, i.e. the Reconstruction and Development Plan. It was concerned mainly with reconstruction and development of the Nigeria as a united, strong and self-reliance nation.

Furthermore, the 4% ceiling placed on the growth rate of commercial banks loans and advances, in 1976 – 1977 was made to apply also to merchant banks at the same period. However, in view of the need of finance the second phase of the indigenisation exercise, loans and advances granted for this purpose were to be excluded in determining the 4% limit. The policy imposing sanction on bank for non compliance to these directives was emphasized. The Central bank rate on stabilization security was raised from 4% to $4^{1}/_{2}$% in order to encourage banks to mobilized savings. As at 1977, the existing credit structures were revised as follows:

TABLE 1

New Credit Structure	Existing Rate	New Rate
1. Minimum rediscount rate	2%	4%
2. Treasury bill rate	2%	3%
3. Treasury certificate 1year maturity	3%	2%

4. Treasury certificate 2 years maturity	8%	8%
5. Produce bill rate.	2%	5%
6. Leading rate:		
Minimum	6%	6%
Maximum	10%	10%
7. Deposit rate:		
Savings minimum	4%	4%
Federal Saving Bank	5%	5%

Source: CBN Annual Report and Statement of Account 31st December, 1977.

Loans the preferred sector within three years were to attract interest rate ranging from 6% to maximum of 8% per annum. While loans maturating after three years were to attract maximum rate of 12%. The policy generally during this period was formulated against the background of continuing inflation, deteriorating balance of payment position respectively.

4.2.3 PHASE III 1980 - 1984

The objectives of monetary policy during this period was to clear the accumulated trade debt and achieve substantial improvement in balance of payment position, stimulate domestic production, reduce the rate of inflation in the economy and mobilize increased domestic and financial resources. In order to encourage increased mobilization of saving and promote a more efficient allocation of available loanable funds, interest rates were raised from $1^{1}/_{2}$% to 2%. Despite the above measures in 1984, Nigerian economy continued to experience a lot of problems such as low domestic output, high rate of inflation, unemployment and inadequate foreign reserves.

4.2.4 PHASE IV 1985 - 1990

This is the period covered by the present administration. It should be noted here that the problems highlighted at the end of the last phase persisted at the dawn of this era.

The priority accorded by the government to the agricultural sector was to encourage the banks and the specialized institution to lend to it which leads to upward revisions in lending rate of Nigerian Agricultural Co-operative Bank (NACB) to agricultural sector. Under the agricultural credit guarantee scheme. Credit to the sector was raised from 6% to 7% approximately.

The economic policies of 1986 were then adopted as a programme to include recovery of the economy over the medium term. The major objectives of the programmes were:

a) To restructure and diversify the productive based of the economy so as to reduce dependence on the oil sector,

b) Finally lay the basis for a reasonable non-inflationary growth.

In anticipation of the expanded role envisaged for the private sector in restructuring and revamping the economy, the rate of increase in commercial bank loan and advances was raised from 7% to 10%. Merchant bank allocation to agricultural sector was raised from 2% to 8%.

During second half of 1986 the programe of economic recovery contained in 1986 budget was by SAP with the aim of altering and structuring the consumption and production pattern of the economy. In line with the objective of SAP, the monetary policy circular of 1986 was demanded twice, the first amendment of 29th September 1986 made the following changes in the monetary policy for the rest of 1986. the existing ceiling of 10% imposed on the rate of credit expansion by the big and small size commercial banks was reduced to 8%.

Consequently, the 1988 policies were designed to consolidate the gain of SAP, stimulate aggregate domestic production and reduce unemployment, specifically; aims of 1988 monetary policies were as follows:

a) Stimulate growth

b) Create more employment

c) Moderate the rate of price inflation and

d) Improve balance of payment

To realize the above aims, the following monetary policies were adopted.

a) 18% growth in money supply compared to 11.8% in 1987

b) 8.5% growth in aggregate domestic credit as compare to 4.4% in 1987.

c) 13.5% growth in credit to private sector as compared to 7.4% in 1987.

d) Reduction of the rediscount rate from 15% to 12.75%.

e) Extension of maturity period on loans granted to cash crop farmers from 5 to 7 years.

The supplementary cash reverse ratio. For the various categories of commercial bank was raised by 2% as follows:-

TABLE 2

Total depreciation Ratio of cash deposit to deposit.

Liabilities	New	Old
a. N300m or more	7.0	5.0
a. N100m or more but less than 300m	6.0	4.0
b. N30m or more but less than N100m	5.0	3.0
c. Less than N30m	4.0	2.0

Source: CBN Annual Report and Statement of Account 1988.

However, in 1989 monetary policy was aimed at enhancing financial swings and efficient resources allocation, stimulate growth in National output and improvement in Balance of payment position. Infact the year also witnessed the establishment of Peoples Bank as a means of providing credit to low income persons who cannot produce collaterals required by conventional banks for loans to achieve this objective. In 1990 budget speech, the government provided N40m for the operation of this bank. On reserve requirement, the minimum liquidity ratio required of commercial banks and merchant banks of 30% and 25% was mentioned in 1989.

Further, existing 15% of commercial banks total credit outstanding for 1990 as compared with those for 1989 is shown below:

		1990	1999
		%	%
(i)	Growth in money supply (m)	13.0	14.65
(ii)	Growth in Aggregate bank credit	13.5	9.5
(iii)	Growth in Credit to Government	10.9	8.3
(iv)	Growth in credit to private sector	15.8	10.7

Notification in 1990 budget speech was the introduction of mandatory interest rate payment on current account. This to us were obviously implications. It will increases competition among Banks, brings about better techniques for managing Deposits. But this means more services which by extension might further the cost of borrowing money from the banks. The monetary authorities should now specify how long a current account should stay to gratify for interest payment and the number of times withdrawal can be effected on such account at a given period.

The federal government guaranteed external loan to states government in order to meet some of their obligations to their populace by supporting industries, provision of employment opportunities and foster the progress of welfare services in the respective states.

External loans guaranteed to state government by Federal Government in 1985.

TABLE 3:

No.	States	Outstanding of state
1.	Anambra	N112.17m
2.	Bauchi	68.44
3.	Bendel	82.48
4.	Benue	163.48
5.	Borno	90.21
6.	Cross River	27.71
7.	Gongola	181.85
8.	Imo	273.27
9.	Kaduna	-
10.	Kano	36.53
11.	Kwara	-
12.	Lagos	139.05
13.	Niger	45.15
14.	Ogun	117.94
15.	Ondo	52.47
16.	Oyo	197.02
17.	Plateau	305.23
18.	Rivers	110.21
19.	Sokoto	151.3

Source: Nigeria under Structural Adjustment Programmes.

The short term nature of the loan made the repayment "bunched" at the same time, thereby making the country inability to pay and credit worthless in the eyes of the lenders. It was due to the above problems that made Nigeria to approach and accept the International Monetary Fund (IMF) conditionalities which includes National Currency devaluation, removal of subsidies commercialization and privatization, deregulation, trade liberalization. Etc.

The introduction of structural adjustment programme lead to the proliferating of banks in the country. As the time President Babangida tool over the management of the economy, there were no fundamental changes in the structure of the banking system. there were as many 28 commercial banks, 12 merchant banks and a few development and specialist banks.

The deregulation lead to the establishment of free interest rate by the banks, this aim at encouraging savings and competition among banks the assumption behind this policy was to increase saving and discourage borrowing because of high cost of capital.

4.4 THE EFFECT OF FOREIGN DEBT ON THE BUSINESS ACTIVITIES IN NIGERIA.

When we are talking about the effect of foreign debt, we are absolutely reforms to the impact of the Structural Adjustment Programme (SAP) because the two are interwoven therefore, inseparable.

With the introduction of SAP and its conditionalities brought a dramatic change in the structure of business activities in Nigeria. Before the introduction of SAP the noticeable impact was stagnation in business field because of lack of capital to run the enterprises, but with the introduction of new economic policy SAP as mentioned above more money was injected into the economy with the assumption to break the vicious – circle of poverty.

Since the launching of SAP the banking industry has been under going a silent revolution with some of SAP policies bringing remarkable challenges to the industry. The introduction of SAP has witnessed an upswing in the number of applications for bank licenses and indeed a lot of banks have been established. The older banks are now facing stiff competition from the new banks both in scouting for customers funds and in securing the employment of highly skilled staff.

Deregulation which has resulted in substantial exchange rate depreciation has led to increased costs of imports, while enhancing the prices of exports consequently, investors, producers and consumers have increasingly resorted to curtailing their demand for imported goods and finding alternative ways of meeting their consumption and input requirements locally.

Deregulation of the foreign exchange market has generally achieved for the naira a market determined exchange rate which made the abolition of the complex and much abused system of discretionary controls such as import licenses and exchange control possible.

The depreciation of the naira enhances the value of domestic product therefore induce Nigerians to produce for export. For instance, the value of non-will exports rose from N552.1 million ($432.0 million) in 1986 to N2.595.6 million ($646.0m) in 1987. In 1986 the total volume and value of agricultural exports (processed and unprocessed products) were 307.0 thousand tones and N482.4 million respectively.

Industrial sector due to deregulation, industrialists now tend to look inwards for their basic raw materials. For example, we now have been brewed from local grains such as soybeans, rice and maize and bread baked from cassava and corn flavour, local industrialists have also been compelled by price considerations to undertake more realistic industrial appraisal prior to investment.

4.5 IMPORTANCE OF BANK CREDIT TO BUSINESS ENTERPRISES.

Banks grant credit to businesses through various facilities common among which are overdrafts. Long-term loans, mortgage loans, term loans, medium term loans, syndicated loans. The above can be re-grouped under long term and short-term sources of fund. Under short term we have unsecured and secured short term loans.

Commercial Bank specialize in short term loans. It is only in rare cases that they agree to go into medium and long-term finance. There are some ventures that are completely banned by the government and are not expected to lend to finance gambling, betting and speculating.

Bank credit plays a crucial role in the developmental activities in a nation both in the private and public sector of the economy, as a result, central bank of Nigeria control the activities of the commercial and merchant banks to ensure maximum attainment of its objectives (developmental objectives). Bank credit provides the business organization with enough capital to enhance mass production. For example, consider the cost of farm inputs such as Fertilizers, tractor service, labour, insecticide etc. from the observation conducted in Doguwar Giginya Local

Government Area indicate that, the 1992 cost of farm input was of the reach of lower income farmers.

1992 cost of farm inputs in Doguwa Local Government Area, Kano State.

TABLE 4

	Land	Fertilizer		Tractor Service		
No. of Acre	Lease Cost of Acre	Type	Cost Per bag	No of Acre	Cost	No. of Acre
1	500	Compound	190	1	2000	1
2	1,000	Super	120	2	7000	2
3	1,500	Urea	250	3	6000	3
4	2000	Can	200	4	8000	4
5	2,500			5	10,000	5
6	3,000			6	12,000	6
7	3,500			7	14,000	7

Authors Compilation

Each acre will consume 30 bags of fertilizer at total application i.e. through out the season. Each acre will consume 10 bags of compound, 5 bags of super, 5 bags can and 10 bags of urea. Total cost of fertilizer per acre is N5,000 when added to other cost, it would amounted to N12,000 i.e., to say it will cost N12,000 to farm one acre of land.

The relative importance of bank loans to a company however, depend on the other various sources through which the company is able to raise fund from the financial system. It also depends on the adequacy and cost of each sources. It has become impossible for enterprises finance their operation without going to the bank and at the same time meet competitive nature of the environment, therefore irrespective of the high interest rate companies rush for loans from the banks.

This action by the commercial enterprise conflict with the objectives of deregulation which was established on the assumption that high interest rate will attract people to save their money in the bank and discourage customers from seeking for loans. In fact the situation became the reverse.

TABLE 5

Analysis of Commercial Banks Loans and Advances

End of Year/Month	Production Agriculture	Manufacturing	Mining and Squaring	Real Estate
1985/Dec.	590.5	2659.9	88.0	1750.5
1986/Dec.	1830.3	4475.5	208.0	2840.5
1987/June.	2119.2	4836.9	206.1	2832.6

Source: Central Bank of Nigeria. Economic and Financial review Vol. 22 No. 3, September, 1988.

From the above, none can see that there is an advance or increase in banks loans and advances to various sector of the economy and emphasis are directed towards area of high priority. For example in 1985 Commercial Bank Credit to agricultural activities was N580.6 but in 1987/June. He allocation rise to N2119.2 million.

The aim of monetary policy to achieve macro-economic objective such as the attainment of a particular level of output, reduction in the unemployment love, price stability, economic growth and a favourable balance of payment etc. For the purpose of achieving the above objectives the Central Bank of Nigeria adopted several strategies which are as follows:

The abolition of bank guarantee and the use of domiciliary account balances as collaterals for bank loans and other facilities in Nigeria.

To strengthen the capital base of banks, capital fund ratio was reviewed upward from 1:12 to 1:10 in addition by May 1989, the Federal government accounts and those of parastatals from merchant and commercial banks vaults to the CBN.

The portfolio behaviour of many banks changes during the review period. Deposit liabilities ceased to be a major sources of fund, hence reductions in investment through rediscounting of short term money market instruments became the sources of most banks.

Some of the manufacturing industries, in order to advert the banks shy rocketing interest rate, explored the capital market for working capital through equity financing. This increases the activity level in the Nigeria capital market.

The policy measure introduced in 1989 culminated in the reduction of inflation rate from the existing 51.5% in June to about 40.9% in December 1989. the short lived reduction in the inflation rate was made at the expense of low capacity utilization in the manufacturing sector of the economy and this resulted into full blown inflation in early 1990s.

The dilemma of the entire economy during the review period battles many economists who believed that appropriate fiscal and monetary policies should have been employed side by side instead of incessant mopping-up exercise which resulted into low industrial output hipper-inflation, low naira exchange rate and increased unemployment.

The maturity structure of Merchant Bank loans and advances continued to deviate from policy guidelines. While short term loans (i.e. those maturing within 12 months) accounted for 50.0% of the total loans and advances as against the prescribed maximum of 20%.

Manufacturing firms in the country devising strategies to stain the worsening liquidity problem confronting the economy. Capacity utilization of industries has dropped to about 25 percent.

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CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.1 SUMMARY

Indeed open market operation is scarcely feasible at all when these markets are very narrow, that is where both the volume of securities and the number of potential transactions are very restricted. An attempt therefore by CBN to buy or sell securities as way of checking and executing monetary policy would only provoke a change in security. In the absence of open market operation, the Central Bank of Nigeria can use its discount rate tool to make the commercial banks more dependent on its credit and by varying this tool, they can thus regulate the flow of money and credit.

Also, tools of monetary policy are more of theoretical jargons when one realizes the problems facing Nigeria. For instance, Agric and Industry dominate the high priority area, but how many of our people can afford the necessary credit worthiness the “5cs” of credit the technical know-how and even much needed local infrastructures.

The autonomous status which placed the CBN under direct administration of the prime minister; or president. This autonomy has been undermined with the advent of military government. Therefore, it led to a lot of amendments Act 1968 and 1970 which affected decrees 40 and 3. The clash of personalities has consequently inconsistency a prominent feature in the formulation and implementation of the monetary policies.

The difficulty in evaluating the contribution of monetary policy to economic stabilization has also been mentioned. Though monetary policy is frequently directed at income, employment and prices, movement in these variables are not satisfactory indicators of its success or otherwise because monetary policy is only one of many forces simultaneously depending on these variables and its effects are subjects to time lag.

However, the monetary policy application and the effect in the Nigerian context cannot be said to be a total failure but have achieved relatively its objective. Infact the monetary authorities in Nigeria have not only succeeded in acquiring an impressive list of control tools or techniques but have also successfully made a selective use of them to suit our financial environment in particular and varying economic conditions in general. In the observed phased of monetary policy history, this does not mean that the path of the policy has been a smooth and easy one.

5.2 CONCLUSION

To conclude, one may say that some of the tools of monetary management by the Central Bank discussed above have some limitations. Because in most developed countries they were designed to carter for their needs and as such inappropriate for a developing country like Nigeria which lacks industrial and infrastructural facilities to implement it. For instance implementation of open operation and discount rate tools are greatly hindered and restricted by the absence or limited capital in the money market.

5.3 RECOMMENDATIONS

(i) It is believed that the starting point to improving the effectiveness of monetary policy is based on the improvement of the institutional environment through which the policy works, in this line, their need is to make efforts to develop line, their need is to make efforts to develop the financial market with developed capital market and, the necessary institutional arrangement for the operations of monetary policy.

(ii) There is the need for stability in government monetary policies, there is a lag between the implementation time and the time result is yield. A stable policy will allow greater impact of the monetary policy to be felt in the economy.

(iii) Despite the fact that deregulation has brought about innovations and introduction of high quality services. This does not eliminate.

(iv) The need for a reasonable level of prudential regulation of banking system Nigeria, being a developing country, cannot afford to leave the financial system unregulated.

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