THE EFFECTIVENESS OF MONETARY POLICY IN THE NIGERIAN FINANCIAL MARKETS 1970 - 1994

BY

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JULY, 1997

DECLARATION

I hereby declare that this thesis is a product of my own research. It has not been accepted anywhere for the purpose of awarding a higher degree. All references have been acknowledged by way of bibliography at the end of the thesis.

MICHAEL MAJU ABU

CERTIFICATION

This thesis entitled **"THE EFFECTIVENESS OF MONETARY POLICY IN THE NIGERIAN FINANCIAL MARKETS 1970 - 1994"** by ABU, Michael Maju meets the regulations governing the award of degree of Masters of Science of Ahmadu Bello University Zaria, and is approved for its contribution for knowledge and literacy presentation

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DEDICATION

This thesis is dedicated to my father and mother Mr. and Mrs Abu Shaibu, especially for their moral care for me all along.

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ABSTRACT

The ability of the monetary authorities of a country especially the developing countries (Nigeria inclusive) to tackle the issues of monetary policy effectively is one of the strong determinants of these policy makers' ability to manage the economy effectively. Therefore, issues of monetary policy and its effectiveness have in the past been analyzed by many researchers and academicians in the field of economics. From the background of the Nigerian monetary policy, this country has been adapting the so called supply-leading financial development - a policy that is expected to encourage the development of financial institutions, especially the money and capital markets so as to inculcate the banking habits into the people. By so doing, the financial markets should develop to enable the development of monetary policy tools for the effective use. The policy markers in this regard concentrated on the development of the financial markets through the introduction of many development banking institutions and persuading commercial banks to open up branches in rural areas.

Since the inception of the CBN therefore, the monetary policy issues were characterised by liberal and tight monetary restraints of the policy makers before the introduction of the Structural Adjustment Programme (SAP) in 1986. The SAP opened ways for the monetary authorities to introduce varieties of policies needed for the effective management of the Nigerian economy. Some of the major changes introduced were the floating of the Naira beginning from the SAP period. Various policy measures were introduced to enable the Naira find its commensurate level within the existing Nigerian economic situation.

To complement the supply-leading financial development policy of Nigeria, the then government of President Babangida introduced the people's bank, and community bank etc. for the development of the financial system.

Interest rates deregulation was a major policy of the monetary authorities tool which was/is part of the authorities' SAP policy. The deregulation was meant to curtail the liquid in the economy which resulted into an inflationary trend that was beyond the control of the authorities. To worsen the situation, the deregulation does not favour savings mobilisation as a result of higher yields from other financial assets other than interest rates.

Moreso, the existence of the Informal Financial Sector (IFS) had rendered some monetary policy tools ineffective. The IFS had resulted in money circulating outside the banking system thereby making it difficult for the liquidity mop-up to be effective except through the use of government expenditures.

It was discovered that as long as the financial markets are developing, policy tools especially the indirect tools are not effective.

That the monetary authorities are not responding quickly to stimuli created by ineffectiveness of monetary policy. It took them much time to identify the problems while the problems take much time to be tackled. The authorities therefore should be extra-vigilant in the area of monetary policy lags.

Policy towards managing inflation should be intensified. By so doing, the public will bring about confidence in the financial markets. Also, the banking habit should be expected to improve the effective management of exchange rate that reduces the rate of

inflation and increases the effectiveness of monetary policy.

In summary, the use of regression analysis shows that there is a positive relationship between interest rates and borrowing. This therefore means that interest rate fluctuations is not a strong tool for controlling credit in the economy. This may be due to expected inflation in Nigeria today.

Michael Maju Abu

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CHAPTER ONE

1.0 INTRODUCTION

The type of economic policy available to the government of any country to help it achieve various economic objectives is referred to as stabilisation policy. Stabilisation policy is sub-divided into macroeconomic measures like monetary policy, fiscal policy, debt management policy and incomes policy. For example, debt management policy is part and parcel of monetary and fiscal policies while incomes policy cannot be discussed without an element of monetary policy.

In Nigeria, the Central Bank is responsible for the prescription and conduct of monetary policy. The Central Bank of Nigeria (C.B.N) was established in March 1958 but it started operations on first July 1959. However, prior to the establishment of the CBN, the issue of monetary policy (if any) was under the control of the West African Currency Board (WACB). This Board was established in 1912 by the Colonial Masters to issue an alternative currency for the gradual monetization of the West African territory in order to maintain a uniform medium of exchange[1]. The use of the Board's currency also brought about the beginning of the end of the barter economy in the West African territory. One of the problems that led to the establishment of the CBN was that the WACB was not under the direct control of the Nigerian government. The monetary policy, among which includes maintaining a hundred per cent gold backing for currency used in Nigeria was the policy used in favour of the initiators (Colonial Masters). The essence of modern central banking is, therefore, the discretionary control of money in Nigeria. The objectives of this intervention in the economic process constitute the main

pre-occupation of monetary policy. This policy therefore has a dominant place amongst public policies in Nigeria. We are interested in finding out how effective it had been over the years. If it has been ineffective, what factors have contributed to the ineffectiveness.

Before and since independence in 1960, efforts at harnessing the country's economic resources were focused on agricultural production for exports. At independence therefore, the country was self-sufficient in food with agriculture contributing about 70% to Gross Domestic product (GDP) and about 80% to export. Also, the industrial production of goods that could steer the economy to grow faster was initiated. It was observed that the annual rate of growth in the economy then (early 1960s) was satisfactory.

According to the world development report of 1987, the Nigerian industrial sector recorded an impressive 13.4% average growth rate between 1965 and 1980, but registered a negative growth rate of 5% to 8% between 1980 and 1985. The emergence of petroleum had not only made Nigeria to neglect agriculture but lured the country into the debt trap. Nigeria raised the first Jumbo loan of $1 billion in January 1978 and the second loan of $750 million in November the same year. By now, it is said that the external debt burden stands at about $29 billion. This had constituted a great set-back for the country as the country uses about 30% of the foreign exchange earnings for debt servicing alone. Also inflation is one of the major problems in the country today. The economy is also characterised by balance of payments problems.

The combination of all these problems which started mostly in the 1970s

continued till the 1980s when the Babangida administration tried to solve the problems by introducing various policy measures in his Structural Adjustment programme (SAP). This programme which started in 1986 was to simply safe the economy from depression. However, the stringent measures adopted in the policy issues resulted in an unusual or unexpected results among which were under-capacity utilisation in the industrial sector and general hardship for the people. Idealy, undercapacity utilisation should and had subsequently resulted in general unemployment of both human and material resources. This is also an impediment to growth and development. There are also shortages of essential goods and services as a result of which demand outstripped supply which should under normal circumstances give birth to the present inflationary trend in the economy.

Since 1991, the CBN (monetary authorities) had persistently decried of the state of the Nigerian economy. That although the growth in domestic output was sustained, the movements in major macroeconomic variables were generally unsatisfactory. The effectiveness in the use of monetary policy can make a difference.

1.1 DEFINITION

The term monetary policy is defined as a policy which deals with discretionary control of money supply by the monetary authorities in order to achieve stated or desired economic goals[3]. Put differently, it is the policy that employs the central bank's control over the supply and cost of money as an instrument for achieving the objectives of economic policy. This simply refers to those actions of the monetary authorities that affects the behaviour of monetary aggregates' interest rates and overall liquidity of the

economy. This definition encompasses control over money and credit. Therefore, the commercial banks and other financial institutions as a channel for the effective transmission of policies are important when discussing monetary policy.

The formulation and implementation of monetary policy as it concerns the economy of a country, are to most people both difficult to understand. Monetary policy is designed to ensure that supply cost and availability of credit are adequate to support desirable and sustainable growth without generating such inflationary pressure that could further put pressure on the external sector particularly the value of exchange rate. In modern economies, commercial banks through their credit operations, supply the oil that lubricates the machinery of trade and industry (Ekukinam, 1971). This policy is defined narrowly to refer to operations that alter the money stock which normally have a sizeable initial effects in financial markets. These financial markets are the well-known money and capital markets in Nigeria. It is important to note that because of their roles in all forms of economic undertakings, whether commerce, industry, construction, transportation, agriculture, commercial banks play decisive roles in the allocation of economic resources.

Generally, monetary policy as agreed among the Central bankers, monetary economists and politicians, seeks to achieve the following objectives:

(a) Promotion of sustainable rate of economic development (growth)

(b) The maintenance of reasonable price stability.

(c) The achievement of full employment; and

(d) The maintenance of Balance of payment equilibrium.

The banking and monetary policies in the first decade of the inception of the CBN had been concerned with the establishment of a sound banking and financial system and of a strong and stable currency in an atmosphere of monetary ease designed to facilitate economic development. An important step in the process of consolidating and evolving a relatively independent monetary policy was taken in 1962 following the declaration in the Budget speech of government to Nigerianise the credit base. By this policy, government aimed at forcing the Nigerian business community, especially the marketing Boards to rely on the local money market instead of on London for their commercial and operating finance requirements.[4] In this, it was viewed that the development of the financial markets will subsequently lead to growth and development of the economy as a whole. The Central Bank in order to effect this policy offered re-discount facilities for all marketing Boards produce bills within the country.

The 1962-68 development plan was aimed at the promotion of sustainable rate of economic development as policy issues. Thus, as early as 1962, the Central Bank's monetary policy attitude in this regard was summed up in the following statement:

> *The Central Bank has been concerned to see that Government should obtain the finance it requires on the most economical basis. These considerations have necessarily conditioned the rates at which federal government loan operations have been undertaken and Treasury Bills issues made.*[5]

In order to help in the development financing processes, the CBN pursued and has

continued to pursue a policy of cheap money. This cheap money policy which enable borrower to have easy access to credit was also extended to agricultural export sector with the view that foreign exchange generated could enhance the growth and development processes in Nigeria.

The Government policy towards the maintenance of reasonable price stability started as far back as the 1970s with the establishment of the Price Control Board. Among the factors that brought about the inflationary trend was the cheap money policy, growth in money which did not match with growth in productive activities, e.g the Adebo and Udoji salary awards.

Another policy aimed at minimising the inflationary trend in the economy was for government to enter into the distributive business directly. A National Supply Company was established to arrange bulk purchases of selected commodities for subsequent sales to the public. This was to assist in the success of price control Board but both the Price Control Board and the National Supply Company failed as a result of corruption. The Credit policy guideline issued by the CBN early in 1971 was meant to allocate credit to priority areas of the economy as a means of controlling inflation.

Import liberalisation was another government policy towards the demand management with the hope that this could force down prices. However, the long-run effect of the import liberalisation was the Balance of payments problem.

There are two important questions facing the economy with large foreign sector. The first relates to the ability of the monetary authorities to offset the impact of foreign reserve on money supply (AJAYI, 1978). The second relates to whether a fixed

exchange rates system acts as a constraint on the efficacy of domestic stabilisation policies since the economy is import dependent.

Ezenwe (1990) pointed out that:

> *One of the reasons for devaluation is its presumed effect of changing relative prices and switching demand from foreign to domestic goods. However, the standard conditions for domestic supply and demand, as well as demand elasticities which must hold to make devaluation successful, are generally lacking. Whereas the prices of the Nigerian major exports are more or less externally determined and so long as essential imports (capital goods, spare parts, raw materials, etc) cannot be cut down drastically, devaluation can only have negligible effect on the improvement of the BOPs.*[6]

Indeed, the greatest or most controversial monetary policy issues in the Nigerian economy today is the issue of exchange rates. The Nigerian currency (Naira) has been devalued beyond unacceptable limits to some policy makers; and has also caused a lot of problems for the economy some of which have been mentioned in this introductory aspects. Year after years, policy statements with respect to monetary policy are made with the hope of achieving a better result at the end of the fiscal period. In most cases we always come out with unsatisfactory performance.

1.1.1 TECHNIQUES/TOOLS OF MONETARY POLICY IN NIGERIA.

Monetary policy formulation and implementation raise very difficult conceptual as well as practical problems. While it is generally agreed that monetary policy may be designed to deal with four broad objectives, namely, a desirable rate of economic growth, price stability, higher rate of employment and a balance of payments equilibrium, in practice one finds that these objectives are in conflict. For example, the pursuit of accelerated economic growth may lead to a rapid importation of capital goods, which imposes in a short run disequilibrating pressures on the BOPs. Inflationary policies may accelerate the rate of growth in a short-run but may not be sustainable in the long run.

The CBN's instruments of monetary policy include the following; open market Operation (OMO), discount rate, reserve requirements, direct control on banking credit and other miscellaneous tools. The CBN usually apply the OMO tool with the view to regulating the cost (interest rates) and availability of credit and subsequently influence commercial bank's credit operation (CBN, 1979). The impact of this is to reduce the cash reserve position of the commercial banking system and thus limit the funds available to the system in carrying out its credit expansion.

The use of discount rate made the CBN the lender of last resort. By so doing it uses the discount rate mechanism by first viewing the situation in the economy. In more sophisticated financial markets therefore, changes in the discount rate produce important effects on credit markets. An increase in minimum re-discount rate is an indication to the credit institutions to raise the cost of credit.

Reserve requirements is simply a legislative control on bank's liquidity and hence the ability of commercial banks to influence their credit operations. An upward/downward adjustment of interest rate is meant to discourage/encourage borrowing from the commercial banks.

Moral suasion which also forms part of direct control of banking system credit is usually a tool for overall sectoral distribution of banking system's credit. For example, the federal government through the monetary authorities usually directs the banks to allow a certain percentage of their credits to the agricultural sector. This policy of direct control is not only applicable to commercial banks but also to non-bank financial intermediaries.

All these instruments have been put in use in this country. One problem envisaged was that the financial institutions in this country sometimes violate the authorities' directives for profit motives. But the co-operation of these financial institutions especially the commercial banks has an impact on the efficacy of monetary policy in Nigeria. If so, what technique(s) should the authorities adopt to solve our economic problems?

1.2 STATEMENT OF THE PROBLEMS.

The current status of monetary theory is such that it is not entirely clear how a change in monetary policy works its way through the financial and real sector of the economy. Although economists agree that the initial impact is mainly on bank reserves, some emphasise subsequent changes in bank credit and interest rates and the influence

they have on aggregate demand through spending on investment goods and consumer durables. Other analysts stress the importance of changes in money supply and argue that these changes may directly affect spending for goods and services as well as indirectly through the prices and yields of financial assets. The disagreement is not much over what variables or which variables enter the transmission process but over their relative importance in the linkage sequences.

Most theories can be accommodated by viewing the transmission process as working through portfolio adjustment, wealth effects and credit availability effects. This project work takes side with credit availability effects and portfolio adjustment process together.

It is a well known fact that all markets are not perfect to enable prices and yields to adjust perfectly to changes in demand and supply to transmit promptly the full effects of monetary policy. The resultant excess demand or supply in the financial markets result in changes in availability of credit rather than price of credit. In Nigeria, it has been observed that commercial bankers employ certain devices to restrict loan demand. In this case, the lending capacity of the banks is restricted by monetary policy; bankers continue to lend only to customers that satisfy their standard of credit worthiness and as authorised by the authorities.

According to Horvitz (1973),[7] there are economists who feel that investment is sufficiently responsive to changes in interest rates to make monetary policy effective. There are others who feel that this is not the case; and that monetary policy cannot be very effective in combating economic instability. These two groups make different

policy recommendation because of their differences in empirical judgement, but their theoritical analysis are similar.

Robert Roosa, (1973) the leading proponents of the credit availability doctrine concluded simply by saying that monetary policy is more effective through changing the availability of credit than through changing its cost. This theory argues that it is possible to restrain spending in inflation without substantial increase in interest rates even if the investment schedule is not very sensitive to changes in interest rates.

The CBN did not appear to be happy with restricting credit to the private sector in the effect of maintaining stability. As far back as 1966, the CBN authorities made it clear that their intention would be to induce a relatively higher rate of credit expansion to the productive sector of the economy for development. This policy is tagged as "Supply-Leading" finance. The general nature of this policy is to stimulate the development of the financial system through government support so that, in the long run, the "banking-habit" is accelerated and a large proportion of the economy's investment is financed through the financial system.[8] Thus, monetary policy was one of expansionism designed to increase credit in selected sectors of economic activity. But the conflict caused by the expansionary monetary policy is how to contain rising prices resultant from excess demand for goods and services.

The counterpart of "Supply-Leading" finance is known as "demand-following" finance which is interpreted as a case of demand creating supply. According to Patrick (1966),[9] the demand-following approach implies that finance is essentially passive in the growth process.

These supply-Leading and demand-following approaches are two schools of thought about the relationship between financial and real development. The theories had failed to resolve the issue - whether the development of financial institution proceeds and therefore plays an active role in the effectiveness of monetary policy for effective growth and development through credit expansion or whether it passively adjust itself to the growth of the real sector.

Former president Babangida seemed to have taken side with the supply-leading policy when his administration introduced the people's bank to supply credit at little or no interest to the members of the public. He also encouraged the institution and development of community banks in this country. However, he had once mentioned that the Nigerian economy had defied all economic solutions when he noticed that inflation, unemployment, debt burden and BOPs problems still persisted having tried to solve these problems through monetary and fiscal policies. Nevertheless, effective monetary policy as an aid to growth will remain an open question unless it is shown how far monetary management is possible and effective in stimulating investment. This is summed up under the keynesian-monetarists controversy about their views that "money does not matter "to money is the determinant factor". This is discussed at length in chapter two (Literature Review).

1.3 OBJECTIVE OF THIS STUDY

The main objective of this study is to examine how effective monetary policy is in Nigeria in recent times. The Nigerian economy, for most of the 1980s and up till the

present period is in a state of crisis. In view of the fact that the transmission mechanism of monetary policy is partly through the financial markets, to study the parts played by some key financial institutions (Commercial Banks) in the effective implementation of monetary policy. Other objectives are:

To study the financial development in Nigeria - supply leading-in relation to expansionary monetary policy vis-a-vis the existence of Informal financial sector with the aim of identifying inflation, Balance of Payments and growth as the monetary authorities are battling with the exchange rate problem.

1.4 JUSTIFICATION OF STUDY

The choice of a monetary system is a monetary policy decision of the utmost importance. To a very large extent it predetermines the ends of the monetary policy which have to be pursued[10]. Nigerian government or the monetary authorities have in the past years been trying to solve the economic problems through various economic policies. The economy does not seem to have responded positively to these policy prescriptions and as a result, the authorities move from one policy to another. Opinion differs among policy makers about whether to regulate or deregulate the economy. For that reason, an incoming administration usually changes the policy of the past administration only to see that nothing positively comes out of the change of policy. We are today faced with the problems of stagflation (inflation and unemployment) debt burden, insufficient growth and development.

The oil resources which is the main source of revenue constitute about 80% of the country's Gross Domestic Product (GDP). With good management, Nigerians should enjoy this gift of nature. These good managers should in one part be in the area of monetary management. Emprical studies are therefore necessary which is what this project is all about.

1.5 METHODOLOGY, SCOPE AND LIMITATIONS

In order to attain the stated objectives, this work relies on theoretical, analytical and descriptive analysis as well as the use of statistical regression analysis. The use of regression analysis is to enable us determine the relationship between interest rates and borrowing or interest rates and domestic credit to the economy. By so doing, we should be able to say if interest rates deregulation as a tool of monetary policy actually served its purpose.

The theoretical and descriptive analysis as well as regression analysis are in use in studying the obtained data as a guiding principle in understanding the movements of some macroeconomic variables. In the course of this investigation therefore, we were in touch with some monetary authorities and financial institutions like the CBN, Lagos and some branches. Our justification for visiting these places was to obtain current data and discuss face to face with some departmental heads in CBN on related issues.

However, like most research studies, this study has its limitations. One of the limitations is the non-availability of current data. In view of the fact that issues of monetary policy is wide in scope, non-bank financial intermediaries are outside the scope

of this project. However, the informal financial sector will be looked into. We will endeavor to make use of available materials to make the result of this work will be useful.

The Model

In our macroeconomic analysis, there is said to be an inverse relationship between the rate of interest and borrowing. The rate of interest has been a good means (tool) and is in use by the monetary authority in Nigeria. It is for this reason that Nigeria deregulated interest rate to enable the demand and supply of credit equilibrate.

This model is made to test the relationship between the rate of interest and borrowing through the use of statistical analysis. The main statistical tool is the regression under which we could obtain the t-statistics, the correlation as well as the strength of relationship between the rate of interest and borrowing. In this model, the banking system's credit to the economy beginning with the Aggregate credit as the dependent variable. The test for the relationship include the use of credit to private sector, credit to government sector as well as credit by commercial banks.

The model specification is as follows:

$C = f(r)$ where

C = credit and r represent the rate of interest.

$AC = a_1 + b_1 r_t$ ..... (1)

$AC_t = a_2 + b_2 r_{t-1}$ ..... (2)

$CPS = a_3 + b_3 r_t$ ..... (3)

$CPS_t = a_4 + b_4 r_{t-1}$..... (4)

$$CGS = a_5 + b_5r_t \quad \text{..... (5)}$$

$$CGS_t = a_6 + b_6r_{t-1} \quad \text{..... (6)}$$

$$CCB = a_7 + b_7r_t \quad \text{..... (7)}$$

$$CCB_t = a_8 + b_8r_{t-1} \quad \text{..... (8)}$$

Where:

AC = Aggregate (total) credit to the economy.

CPS = Credit to private sector

CGS = Credit to Government Sector

CCB = Credit by Commercial Banks.

In order to reduce the figure in use which are those in appendix III, we obtain the indices by making the year 1980 as the base year. We are interested in the relationship between interest rates and borrowing.

1.6 SOURCES OF DATA

The sources of data for this research work are all secondary data. The statistical data were obtained from various publications of the Federal Office of Statistic (FOS) and CBN journals, various other authentic journals, magazines and reports. Also, the International Monetary Fund (IMF) financial statistical publications were used.

1.7 ORGANISATION OF WORK.

This work is divided into six chapters. Chapter one is the introductory aspect embracing the research problem(s) objectives of study, justification, methodology and the

sources of data. Chapter two reviews of the relevant literature. The third chapter deals with, "Monetary Policy Implementation in Nigeria". Chapter four - addresses the performance appraisal of the Nigerian financial markets. Chapter five examines the exchange rate management and the effectiveness of monetary policy in Nigeria. The last chapter (chapter five) concludes the work with summary and relevant policy prescriptions.

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CHAPTER TWO

2.0 REVIEW OF PAST LITERATURES.

The precise assessment of the effectiveness of monetary policy measures would be possible first by looking at the objectives and at the same time reviewing the policy of other countries especially the developed countries.[1] This is because policies differ among countries which also makes the objectives differ among countries. Monetary authorities in all countries find it necessary to select as policy targets objectives that are short-term and more immediate than the comprehensive goals of economic policy.

According to HODGMAN[2] D.R., three main types of intermediate objectives as targets for monetary policy pre-dominate in most developing countries including Nigeria and some developed countries studied. These are monetary aggregates, interest rates, and flow of credit. In the category of monetary aggregates it is convenient to include not only the money supply in its definitions but also the related quantities of monetary base (that is claims or potential claims against the Central Bank) and the liquid assets held either by the banking system or by the economy at large. What these targets have in common despite important differences in precise content is an emphasis on control by monetary authorities of the supply of money. Usually, such emphasis is accompanied by a minimum of direct intervention in the process of credit market. It is, therefore, necessary for us to start here with the study of some developed countries and policies that pre-dominate in these countries.

2.1 POLICY ISSUES OF SOME DEVELOPED COUNTRIES

In Germany and the Netherlands, the monetary authorities have been concerned primarily with monetary aggregates (BODGMAN, 1974). In Belgium, France and the United Kingdom, the primary responsibility has been assigned to the control of interest rates and indirect allocation. The Italian monetary authorities had chosen an intermediate position on the spectrum (HODGMAN, 1974). In Germany therefore, the Central bank seeks to increase or decrease the liquidity of commercial banks and other credit institutions in its effort to manage aggregate demand. The authorities it was said have not sought to regulate interest rates through administrative controls since an attempt to do that was unsuccessful between March 1957 to March 1967[3].

Monetary authorities in the Netherlands pay particular attention to the stock of liquid assets in the economy. Administrative intervention by the authorities into credit, capital and foreign exchange markets have been undertaken primarily to aid in regulating the stock of liquid assets rather than to influence the domestic allocation of credit. (BODGMAN, 1974). Thus, with the use of credit ceilings, they have sought to curb aggregate spending without raising domestic interest rates. Other regulations on commercial and savings banks have sought to preserve the authorities' distinction between noninflationary lending based on savings and inflationary lending that add to the supply of liquidity in the economy.

In Belgium, the authorities have emphasised interest rates and credit allocation targets. Also in France, the goal of credit allocation and control of interest rates has taken precedence over control of any monetary aggregate[4]. The National Credit Control

also do pay some attention to the ratio of money supply to Gross national product (GNP) valued at current prices. Rediscounting is the principal channel through which the Central Bank supply credit to the French Banking system. The French national policy has emphasised low interest rates as a stimulus to investment and as a factor in keeping costs of French export industries competitive in the world markets. Large loans to big borrowers have subjected to administrative control/review by the bank de France.

In United Kingdom, the monetary authorities also chose interest rates and credit flows as their principal intermediate objectives in seeking to contribute to the broader goals of full employment, economic growth, price stability and balance of payment equilibrium. The Bank of England exercises a form of administrative control over an array of short-term interest rates in the traditional money market and over clearing-bank lending and borrowing rates. By imposing loan ceilings on banks, the Bank of England sought to reduce the flow of credit to the private sector while sometimes exempting loans for exports. In their commitment to interest rates and credit flows, the monetary authority had the support of the theoritical arguments advanced in the report of the prestigious Radcliffe Committee[6].

In Italy, the monetary authority stress a monetary aggregate as the principal target for Central Bank Policy. Here, emphasis is on the monetary base. The Italian concept of monetary base includes potential as well as actual claims against the Central Bank[7]. The monetary authority have exhibited a great concern with the allocation of credit within the economy. Within prescribed limits, banks are permitted to substitute Treasury Bills, agricultural, mortgage and other specific long-term bonds for cash deposits at the Central

bank in meeting minimum reserve requirements. The authority set maximum interest rates and maturity for bank deposits.

By looking at some key monetary policy issues in some developed countries as above, we may be able to compare and contrast the policy issues in Nigeria with those in developed countries. This is also meant to compare and contrast the monetary policy instruments with the aim of determining their respective levels of effectiveness. The degree of success achieved by monetary policy is significantly influenced by the characteristic of the general financial system within which it operates. This is true whether monetary authorities approach their task by concentrating on the control of a monetary aggregate or seeking to control interest rates and credit flows. But there are important differences in the requirements for success that depend on the choice of policy objective. It is pertinent to note that interest rates policy plays a key role in most developed countries studied.

2.2 INTEREST RATES POLICY IN MONETARY MANAGEMENT.

We shall start by asking what are the channels through which monetary measures are transmitted to the real sector in which decisions to produce, to consume (or conversely to save) and to invest are undertaken? Answering from the theory of monetary policy, monetary measures can influence the spending behavior of the economy by affecting the cost of credit (interest rates) and availability of credit.

2.2.1 THE LOANABLE FUND THEORY OF INTEREST RATE

In a classical world of rational behaviour, the monetary unit is seen as a medium of exchange to be used only in facilitating transactions.[8] People do not hold idle money, they always get rid of it in exchange of real output, which according to the classists is in accordance with the full use of factors of production. The level of money income, (real output multiplied by the general price level) is equal to the quantity of money multiplied by its velocity of circulation. This view about the function of money is an ingredient of the classical view about monetary flows in the economy: every change in income leads to an equal change in expenditure so that the monetary circuit is always closed. It is assumed that an increase in income is not consumed but saved; while it is also taken for granted that these savings will lead entirely to investment; so that the whole income is spent (WRIGHTSMAN, 1971).

The rate of interest is the mechanism whereby savings are brought into equilibrium with investment regardless of the level of money income. Savings represent the supply side and investment represent the demand side of the market. This action of savings reflects abstention from consumption (thriftness) and the action of investment reflects the profitability of investment (productivity). The rate of interest plays an allocative role in what is to be saved and what is to be invested out of a given money income. When the rate is high, income recipients desire to save more than when the rate is low. Savings is therefore an increasing function of the rate and investment is a decreasing function of the same rate. Through the fluctuation of the rate, ex ante savings are always equal to ex ante investment and the equilibrating process is carried out by the

rate of interest. should the rate of interest be hampered from flunctuating by whatever forces, saving and investment (in ex ante sense) will not be equal.

The loanable funds theory throws much light on the economic significant of hoarding/dishoarding and the interference of banks in the savings-investment process. The theory differentiated between two types of interest rates; the natural rate of interest and the money rate of interest which can be taken to be the nonequilibrium rate determined by the conditions in the money market. Starting from a full employment state, Wicksell[9] argued that unless the natural rate of interest is equal to the money rate, inflationary or deflationary tendencies will prevail. figure one (1) is a depiction of his argument.

Fig. One(1), the rate of interest: Classical view.
The vertical axis measures interest rate and the horizontal axis measures the

volume of savings and investment. The savings and investment schedule are represented by two straight lines SS and II respectively. The intersection of the two schedules determine the interest rate r_o. This is the equilibrium rate because it is the only rate at which savings are equal to investment. If entrepreneurs desire to invest more at every rate of interest because of an increase in productivity, the investment schedule shifts to the right changing its place from II to I_1I_1. Unless the savings schedule shifts to the right by the same distance reflecting an increase in thriftness, new investment will not be financed at the rate r_o. If this does not happen, entreprenuers have to pay a higher rate of interest and in equilibrium given a supply schedule of savings, that rate will settle at r_1. Suppose that the banks accommodate the business enterprises by supplying new money to close the gap between savings and investment (measured by the distance ab) at the old rate r_o. This action means that banks' interference in the capital market imposed a money rate of interest below the natural rate of interest r_1; that is, banks pegged the rate at r_o. At this rate, people do not save more since the incentive to do this is absent. The pegged rate of interest is too low to induce people to save more. The consequence is that people's demand for goods and services for consumption purposes is not reduced to compensate the increased demand for investment purposes. The result will be an excess demand for goods and services to be absorbed by higher prices. Unless the source of excess demand is eliminated by a rise in interest rate to its natural level r_i which will reduce both consumption and investment demand, the rise in price will accumulate indefinitely. (Nassef, 1974). The opposite sequence of events will take place when the investment schedule shifts to the left and banks maintain the money rate of

interest above the natural rate of interest. A state of deficiency in aggregate demand will occur because at the higher rate of interest (the market rate), people are induced to save more and decrease their consumption. This state of affairs according to the Wicksellian theory, will result in an indefinate fall in prices unless banks stop absorbing funds from the capital market.

An analysis could be drawn with regards to the action of hoarding/dishoarding. The action of hoarding is the desire to hold cash instead of interest bearing assets like bonds. This action will not only reduce the flow of new savings into the capital market, but also it may entail the disposition of accumulated wealth in the form of interest bearing assets. The result is that the market rate of interest is getting higher than the natural rate of interest, reducing investment without reducing desired savings. A state of deficiency in aggregate demand occurs and price continues to fall unless one (or both) of the two components of aggregate demand is increased. On the other hand, the action of dishoarding is the desire to hold interest bearing assets instead of cash balances. This action will not only augment the volume of new savings flowing into the capital market but will entail also the exchange of the accumulated wealth in the form of idle balances for interest bearing assets. The consequence is that market rate of interest is set below the natural rate of interest increasing consumption and investment.

The Wicksellian analysis shows not only how the interest rates mechanism could be interrupted and prevented from equating ex ante savings with ex ante investment, but it also shows what would happen to the general price level consequent upon the disturbance in the capital market. The following set of equations would clarify the

contention of Wicksell's argument. The equilibrium condition in the capital market can be written as follows:

$$S + (DM) + \triangle M = I \quad \ldots\ldots\ldots\ldots\ldots (1)$$

where S = savings, DM = dishoarding (negative in case of hoarding), DM = increase in money supply and I = investment.

Savings and investment are functions of the rate of interest:

$$S = S(r) \text{ and } \frac{\delta S}{\delta r} > O \quad \ldots\ldots\ldots\ldots\ldots (2)$$

$$I = i(r) \text{ and } \frac{\delta I}{\delta r} < O \quad \ldots\ldots\ldots\ldots\ldots (3)$$

The increase in money supply ($\triangle M$) can be considered as exogenous variables. Then in order to be able to determine the rate of interest, we have to know the rate of interest, we have to know DH. We can define DH as follows.

$$DH = M - K(PY) \quad \ldots\ldots\ldots\ldots\ldots (4)$$

where M = the stock of money

Y = the real output (both are assumed given)

K = the reciprocal of velocity of circulation.

P = the general price level.

Now, we have a system of four equations with five independent variable: S, I, r, DH and P. The system is indeterminate unless we know DH, the price level is not

determined[10].

2.2.2 THE LIQUIDITY PREFERENCE THEORY OF INTEREST RATE.

The liquidity preference theory claims that the demand for and supply of money are the determinants of interest rates. Conventionally, money is demanded for many purposes among which include transactions, precautionary and speculative purposes. Since people cannot hold more money than what is supplied, a given stock of money is distributed among these different purposes. With the acquisition of money for precautionary and speculative purposes, money as looked upon is a financial asset rather than as a medium of exchange.

A part of saving may be hoarded rather than lent or invested. A decision to hoard is distinguished from a decision to save in so far as saving is abstention from consumption while hoarding entails the desire to hold wealth in the form of money balances. To hold barren money entails the sacrifice of future interest income. Thus the action of hoarding is related to the rate of interest.

The amount of idle balances which people desire to hold at various interest rates constitute the demand schedule for idle balances: the liquidity preference function. Liquidity preference is a decreasing function of the rate of interest; when the rate of interest is high, people's desire to accumulate idle balances is less than when the rate of interest is low. It should be emphasised that the liquidity preference depends primarily upon the relation between the current rate of interest and the state of expectation (SILBER 1974). That the liquidity preference is a decreasing function of the rate of

interest relates to the matter of expectation about a safe future rate of interest. Individuals who think that the current rate is above the safe rate will not wish to hold much cash but instead will wish to hold their resources in securities. Those individuals who think that the rate is too low will want to hold cash or will at least want to hold some considerable part of their resources in cash. The market strike a balance between these opposing opinion. Thus the balance of opinion with respect to future rate of interest influences the actual rate of interest.

The liquidity preference theory claimed that the demand for liquidity in conjuction with the supply of money determines the rate of interest. Figure two (2) is an illustration of the theory.

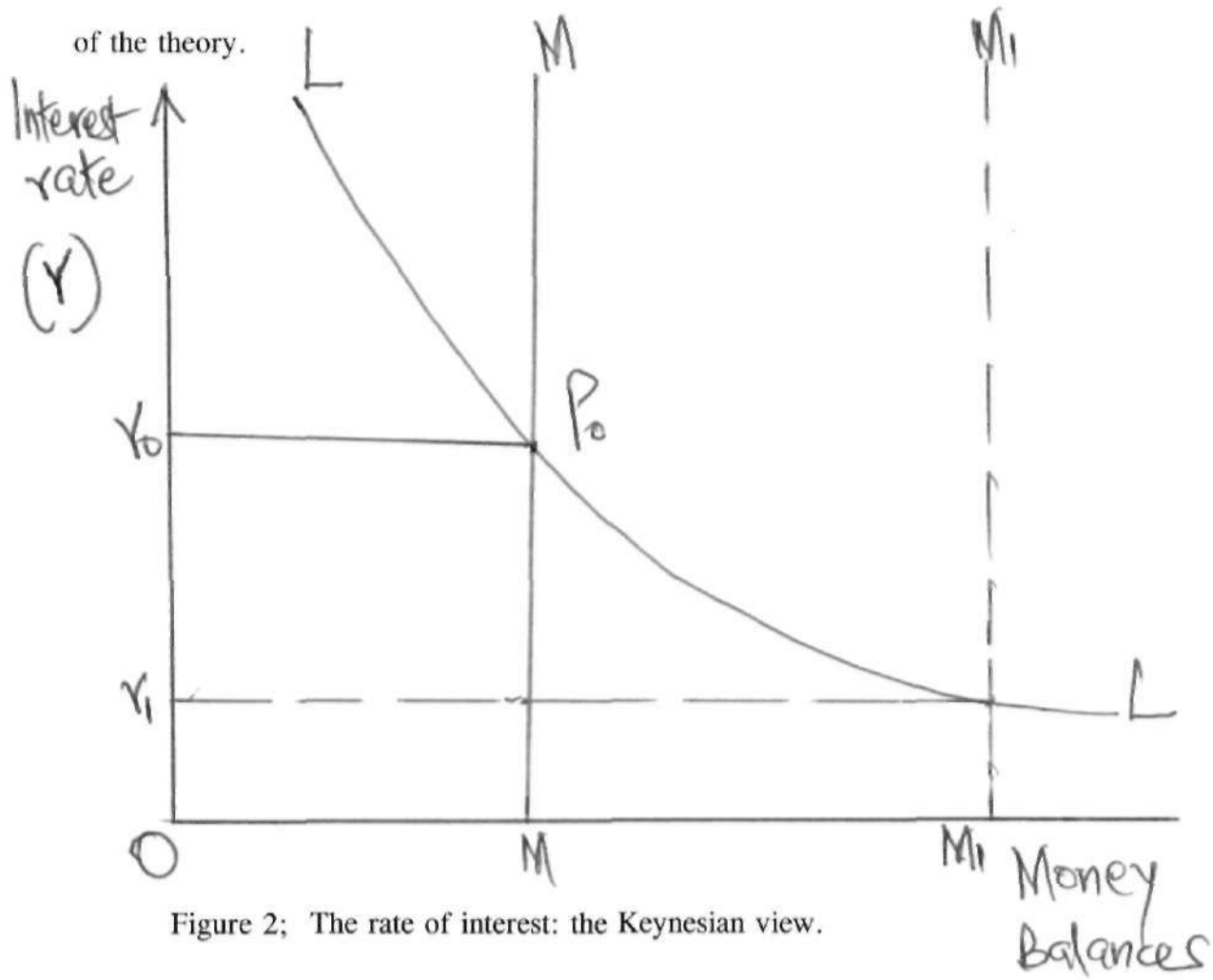


Figure 2; The rate of interest: the Keynesian view.

From figure two, the supply of money curve (MM) is drawn as a vertical line reflecting that money supply is under the control of the monetary authority and interest inelastic. The demand curve for idle balances LL, is drawn as nearly vertical at very high interest rate levels and nearly horizontal at very low interest rate level. In the first case, the demand for idle balances is interest inelastic and the second case is the well-known liquidity trap case. Apart from the two extreme cases, the demand schedule for idle balances is smoothly downward sloping.

The intersection of the demand and supply schedule of money determines the equilibrium rate of interest r_o. The figure also shows that as a result of autonomous increase in the stock of money, the supply of money schedule shifts to the right from MM to M_1M_1. The new supply schedule will intercept the given demand schedule at a lower rate of interest r_1. This means that the monetary authority can influence the level of interest rate by manipulating the stock of money. In figure two, the rate of interest is reduced from r_o to a lower level r_1 when the stock of money is increased by an amount measured by the distance $M - M_1$.

The neo-keynesian theory developed by Professor J.R. Hicks in which the rate of interest and income are determined simultanously are as shown in figure 3. The Is is the locus of the saving schedule and the investment schedule at different combinations of income and the rate of interest compatible with equilibrium in the output market. The IS curve is downward sloping since at low rate of interest, investment is enlarged and so are savings and income Via the multiplier sequence.

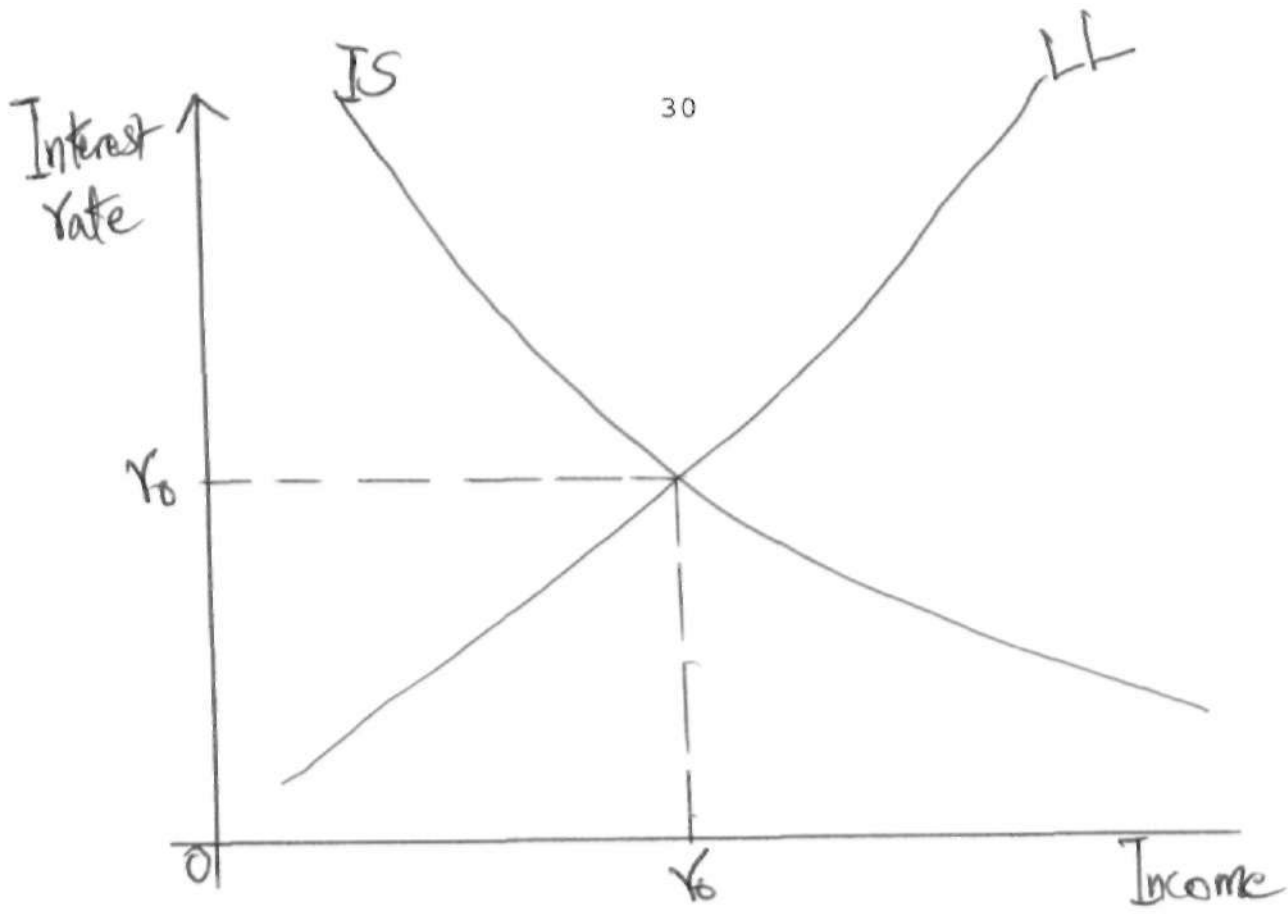


Figure 3; Interest rate, the Hicksian View.

The LL curve shows the rate of interest at which the demand for money will be equal to a given supply of money at each given income. It gives a second relation between income and the rate of interest compatible with equilibrium in the money market. To induce the speculators to release part of the idle balances, the rate of interest must rise. The intersection of the two curves gives a unique combination of interest rate and income (R_o, Y_o) at which:

(i) Savings = investment

(ii) The demand for money = the supply for money.

According to Hicks[12] it is only in a state of full equilibrium that the two rates are identical. He argued that any change in the inducement to invest or the propensity to consume will shift the IS curve. Also any change in the liquidity preference or monetary

policy will shift the LL curve. If as a result of such a change the investment rate is raised above the money rate, income tends to rise; in the opposite case, income may fall. The extent to which income rises or falls depends on the elasticity of the curves (Hicks, 1937).

In summary of the above, the expenditure-income approach to monetary analysis and policy is well established. A determinate theory of interest rate is based on: the investment demand function, the savings function (or conversely the consumption function), the liquidity preference theory and the quantity of money. Analytically, both the liquidity preference theory and the loanable funds theory are built around these basic functions. Primarily, in a theory of monetary policy, we are interested in knowing how monetary actions can affect the spending behaviour in the economy. This has to do with two parameters of monetary policy; the stock of money and the rate of interest. The direct policy parameter is the stock of money, the manipulation of which can influence the rate of interest.

2.3 SOME PROPOSITIONS OF THE THEORY OF MONETARY POLICY

According to the liquidity preference theory, an autonomous increase in the stock of money, everything being equal, must result in a decrease in the rate of interest. The lower rate of interest will stimulate investment which, via the multiplier effect, will lead to an increase in income. The effectuation of this process will be hampered by the existence of a liquidity trap or/and when the investment schedule is interest inelastic. When the economy is trapped in liquidity, individuals prefer to hold wealth in the form

of money balances instead of investment goods. Any increase in the stock of money is ineffective in influencing the rate of interest. When the marginal efficiency of investment has already reached a level below that bottom, further stimulation of investment by monetary measures is rendered impossible.

Although these extreme cases are theoretically possible, the point to be stressed is that the degree of interest elasticity (of the interest rate determinants) is of prime importance for the effectiveness of monetary measure working via the interest rate channel. Multiple interest rate changes are required in order to influence decisions to produce, to consume, and invest in case the aggregate demand for goods and services is negligibly influenced by the interest rate changes. With regards to the interest rate element in investment decision making, Sayer says that:

> *The evidence heard by Radcliffe Committee in 1958 indicated that the reaction of firms may be very slow and will not come out at all if the movement in rates are soon reversed. Those who plan a great-part of spending on capital works and equipment in the private sector of British economy appeared to base their calculations on the conventional rate of interest whatever the rate ruling in the market at the moment. These conventional rates, however, respond eventually to a change in market rates that is persistent and is a big move enough to represent "a change in gear"*[13].

All these would lead to the conclusion that at least heavy reliance on the rate of interest manipulation to stimulate growth or to combat inflation is misplaced.

With the emergence of the availability doctrine, the rate of interest survived in monetary discussion as a tool for stabilisation policy. In case of availability of loanable funds rather than their cost (interest rate) is an important determinant of aggregate demand; the rate of interest may have a role in influencing the availability of credit and consequently aggregate demand.

The availability doctrine is a set of postulations concerning the working of monetary policy. It articulates the chain of effects which would emerge from an open market operation on the contractionary side (sales of government securities). The effective thrust of these operations is to induce a liquidity pressure, change in expectations, tight bank-lending policy and all these were to lead to an absolute decrease in the supply of loanable funds to the private sector of the economy.

2.3.1 THE LIQUIDITY ARGUMENT

Usually, liquidity means the easiness in converting financial assets into money. Assets such as Treasury Bills, commercial bills, bonds and shares are equivalent to money as a store of value. These assets can be converted into money; the easier an asset can be converted into money, the more liquid is attainable. The liquidity implies the occurrence of financial transactions; and with sales and purchases of financial assets, gains and losses are expected.

The availability doctrine, postulates that the desire for liquidity among individuals

and firms is an increasing function of the interest rate of government bonds (Lind, 1974). This may seem to be a contradiction to Keynes' liquidity preference theory, according to which the demand for liquidity is a decreasing function of the interest rate. The explanation of this apparent contradiction is simple. Keynes' theory focuses attention on the choice between money and bonds, whereas the availability doctrine is concerned also with the choice between government securities and private loans. In both theories, an increased willingness to hold government securities at higher interest rates is assumed. This results in the shift out of money in Keynesian analysis and in the new theory in shift out of private loans.

2.3.2 THE EXPECTATION ARGUMENT

A tight monetary policy characterised by increased interest rates on government securities (sales of government securities) has its own psychological effects on expectations of asset holders with regards to credit and business future conditions. It is argued that lenders should abstain from lending expecting that the increase in the interest rates would be persistent in future so that it would be better for them to wait and see (NASSEF, 1974). They should sacrifice an interest income by abstaining from lending but it would happen that in the coming days, they would compensate this sacrifice by lending their funds against higher interest rates. As a result of their reluctance to lend, lenders keep their loanable funds in liquid forms and the supply of loanable funds to the private sector of the economy is consequently reduced.

On the other hand, borrowers would take the tight credit condition as a sign of

coming hard times for their business activities, and would now postpone carrying out planned investment outlay; also 'waiting and seeing' whether the rate of interest would fall in coming days. As a result, they become reluctant to incur liabilities on themselves and consequently reduce their demand for loanable funds.

Taken together, uncertainty about future credit and business conditions would result in an absolute reduction in the demand for and supply of loanable funds.

2.3.3 TIGHT BANK LENDING POLICY ARGUMENT

As earlier observed, the uncertainty about future expectation of credit and business conditions would result in the shift of the supply schedule of the loanable fund to the left. This is therefore as a result of the combined effect resulting from abstention of private lenders and banks from lending. The less pessimistic segment of borrowers about future credit market and business conditions are not deterred from seeking funds against high interest rates on borrowed funds. If they are refused by private lenders, they will turn to banks for loans no matter the cost of borrowing. Established customers in most cases cannot be denied loans by their banks no matter the tight credit conditions[14]. Banks may therefore start to seek for funds from the central bank at high re-discount rate or seek funds from the open market. They may start to unload their secondary line of reserves by selling government securities at capital losses which can be compensated by extending private loans at higher loan rate (Furness, 1975). Thus, the frustration of excess demand is effectuated via higher loan interest rates and via limitations in availability of credit. The expectation argument could still be linked with

the excess demand for credit at higher loan interest rate. The demand for loan at high interest rate could still be high if and only if it is expected that the cost of acquisition of credit would continue to be high. This happened in Nigeria during the Babangida's interest rate deregulation policy when people continued demanding for loans even at more than 100% increase in the rate charged by the banks.

The bulk of the discussions on monetary policy centred on money with a widespread agreement that money is of importance in determining the course of economic events. There is, however, substantial disagreement concerning the extent to which money matters (that is, the size of money multiplier). In fact, a spectrum of views about the importance of money ranges from "money matters little" at one extreme to "money alone matters" at the other extreme. What is important is the extent to which these differences in opinion may be traced to differences in transmission mechanism explaining how monetary influences affect real output, employment and price level.

2.4 THE MONETARIST-KEYNESIAN DEBATE

2.4.1 MONETARIST VIEW OF MONEY

The monetarists are the group of economists called the Quantity Theorists. Their lineage could be traced as far back as Jean Bodin in the Sixteenth Century, through John Locke, David Hume, David Ricardo, John Stuart Mill, up to Irving Fisher in 1920s and 1930s and now Milton Friedman in the 1960s and 1970s[15].

According to the monetarist, there is a direct and reliable link between the money supply and Gross national product (GNP). That link is the stability of monetary velocity.

Because of the link, a change in the money supply will change aggregate spending and GNP by a predictable amount. (SILBER 1974).

If the money supply is increased during a recession, the increased spending primarily will raise employment and real output; on the other hand if the economy is already close to full employment, then the increase in GNP will consist mainly of higher prices.

How high then will GNP go? The answer according to the monetarists is that spending on real goods and services will increase until GNP has risen to the point where the relationship between it and the money supply becomes the same as it had been before the increase in money supply. The relationship is exactly what we mean by monetary velocity (GNP/M). When GNP has reached the point where it once again stands in its previous ratio to the money supply, the public will finally be satisfied to hold the increased stock of money as a medium of exchange and spending will level off. The ideal situation for the central bank therefore is the stable velocity, or at least one that is changing slowly and predictably over a period of time, and this is precisely the main assumption of the monetarists. This assumed stable velocity could enable the Central Bank to induce almost any volume of spending it wants simply by adjusting the money supply to the known velocity.

In the monetarist world, there is no need to pay any attention to fiscal policy (the Keynesian Pet). Changes in money supply can do the whole job and stabilisation policy should concentrate on that alone.

2.4.2 THE KEYNESIAN VIEW OF MONEY

John Maynard Keynes had an opposing view on the channels through which the money supply affects GNP. His opinion is that velocity is not viewed as very stable in either the short or the long-run.[16]. Thus, this increases the liquidity of the public, but people may want simply to hold this additional liquidity. The entire process may end there. The public gets additional money and hoards it. The money supply had increased but GNP is unaffected. Velocity has fallen and this is the liquidity trap case.

Another way the increase in money supply can be short circuited out of the income stream occurs when the increase is accompanied by a simultaneous shift in the demand for money.

In the monetarist world, they are likely to spend it on real assets, on real goods and services, thereby directly driving up GNP. In the Keynesian world, however, they would spend it not on real assets but on financial assets, such as stocks and bonds. The monetarists therefore stress the transactions motive for holding money while the Keynesian stress the speculative motive.

In the Keynesian world, when people increase their demand for financial assets, the prices of securities rise and interest rates fall. This drop of interest rates may then induce some business firms or customers to borrow and purchase real goods and services. To summarise the main Keynesian view a change in the money supply can only affect aggregate spending and GNP if it first changes interest rates, and only if business or consumer spending is sensitive to those changes.

One long-standing Keynesian objection to monetary policy is the view that

monetary policy is a dangerous weapon especially when used to fight inflation[17]. That it cannot be used in moderation and if it is effective at all it is likely to be too effective.

According to Hanson:

> *The monetary weapon has a peculiar characteristic that it is scarcely at all effective unless the brakes are applied so vigorously as to precipitate a collapse. Those who glibly talk about controlling inflation by monetary policy have failed to consider that moderate monetary measures by themselves alone are relatively ineffective while drastic measures may easily turn the economy into a fail spin*[18].

However, some economists considered as Neo-Keynesians substantially took different positions on particular issues. Neo-Keynesians or the Yale school, for example, consider that:

(1) The stock of money, conventionally defined is not an exogenous variable completely controlled by the monetary authorities but is partly an endogenous quantity that reflects the economic behaviour of financial intermediaries and non-financial private economic units.

(2) That the sharp traditional distinctions between money and other assets and between commercial banks and other financial intermediaries are not warranted. Instead, monetary analysis should focus on demand for supplies of the whole spectrum of assets rather than on the quantity and velocity of money.[19].

The Keynesians and monetarist argument could be summed-up in the following simple way. The monetarists claim that monetary policy should be conducted only for the purpose of controlling the money supply; while the Keynesian argue that interest rate and credit availability or credit conditions are more important than money supply, and in any event, fiscal policy is more important than either.

2.5 THE QUANTIFY THEORY OF MONEY

Money according to the classicists, is a veil to be pierced by the analytical mind of the economists examining the determinants of real economic activity[20]. Money affects the price level but nothing else.[21] An increase in the supply of money leads to an increase in the prices of all goods and services but everything else - most notably the level of real economic activity, the rate of interest and people's real income - remains unchanged.[22] This conclusion expresses the quantity theory of money. The logic behind this is as follow:

We start with the equation of exchange which is not the quantity theory but simply an identity.

$$MV = Py \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

where M is the supply of money

V is the velocity or its rate of turnover, P is the price level and y is the level of real income.

On the left hand side, the stock of money (in Naira) is represented by M. When multiplied by its Velocity the number of times such naira are used in the purchase of

goods and services; MV also equal total spending or GNP. That is the equation of exchange. It says that total spending (MV) equals the value of what is bought (Py).

The equation of exchange was originally put forth in a slightly different form. The level of real income on the right hand side was replaced by T, the total level of transactions. This brought the equation of exchange to be:

$$MV = PT \quad \text{..... (2)}$$

and the velocity figure on the left hand side is called transaction velocity. Irving Fisher, the brilliant Yale economist was most eloquent expositor of the equation of exchange as just presented. (RITTER, 1981).

There is also another version of the equation of exchange associated with economists of Cambridge University in England. On their own, they concentrated on the fraction of GNP people hold in the form of money. that is as follows:

$$M = RPy \quad \text{..... (3)}$$

where R is the fraction of GNP that people have command over in the form of money balances. Obviously, $R = 1/V$, so equation one and three are equivalent from the algebraic standpoint. We could move from the equation of exchange (an identify) to the quantity theory of money (a cause-and-effect hypothesis). The quantity theory implied that increase in the supply of money cause increase in the price level. To be precise: a change in money supply, according to the quantity theory of money produces a proportionate change in price level[23]. For example, if money supply doubles, so does the price level. This cause-and-effect conclusion follows from two basic propositions of the classical school. First on the right hand side of equation one, MV = Py, y is

assumed fixed at full employment. Second, that velocity is assumed to be fixed by the payment habits of the community. If MV = Py, V and y are assumed to be fixed, then if M doubles, it follows that P must double.

The classical economists (as well as their monetarists descendants) insist on clearly distinguishing between the real versus nominal consequences of anything in general and money in particular. A change in the money supply leaves the real amount of goods and services produced (real GNP) unchanged, but increase the Naira value of GNP (norminal GNP). Keynesians are much less concerned with the real versus norminal distinction[24].

2.6 FINANCIAL MARKETS AND ECONOMIC ACTIVITY

Financial markets are the markets for both long-term and short-term loans. The long-term loan market is called the capital market while the short-term loan market is called the money market.

Financial markets are the transmission mechanism between saver-lenders and borrower-spenders. (Henning, 1974). Through a wide variety of techniques, instruments and institutions, financial markets mobilize the savings and channel them into the hands of borrower-spenders who need more funds than they have in hand. Therefore, the existence of highly developed, widely acceptable and smoothly functioning financial markets is of crucial importance in transmitting savings into the hands of those desiring to make investment expenditures[25].

The very first sector to experience the impact of monetary policy is, of course,

the financial markets[26]. Therefore changes in the financial markets are frequently used as indicators of the impact of monetary policy and as guides for further action. The growth of financial markets means a growth in substitute for money, funds could be held in form of money market instruments instead of money. With increase in volume of money market instruments, the money supply need not rise as rapidly as would otherwise be desirable (Henning, 1974).

At the same time, more commercial paper probably means that more spending for goods is financed; increase spending means more rapid turnover, or velocity of money. Rise in velocity and fluctuations in short term interest rates make the selection of appropriate monetary policy action difficult. Yet an understanding of these factors and all other mentioned theories in this chapter is essential for effective monetary policy otherwise we might be in danger of finding that monetary authority, "instead of controlling the heat.....had merely been diddling the thermometer (wallich 1971)

2.7 MONETARY POLICY IN NIGERIA.

The beginning of the pronouncement of monetary policy in Nigeria was after the institution of the Central Bank of Nigeria (CBN). The CBN was established by an Act of parliament in March 1958 and commenced operation in July 1959. Prior to the establishment of the CBN, the monetisation of the Nigerian economy was through the West African Currency Board (WACB) since 1912. Because of the Board's policy of maintaining a hundred per cent gold backing for currency in circulation, the government had little or no control over the money stock in the country (ODAMA 1978). Besides,

the WACB was not under the direct control of the Nigerian government. This Board introduced the West African Pound to replace the varieties of circulating media of exchange in Nigeria and other West African countries. The "native currency" system included items such as cowries, manillas, brass or copper rods, bottles, cases of gin, livestock and slaves[27]. This position, however changed at the establishment of the central bank and the enactment of the necessary banking laws that were to enable the institution to mint and circulate the Nigerian made money.

In the first five years of the establishment of the CBN, its major pre-occupation was with the active development of the institutional framework required to operate a modern financial system. The CBN also actively promoted the development of a capital market by giving support to the establishment of the Lagos Stock Exchange in 1961.

Cheap money policy was vigorously pursued by the CBN especially at the beginning of the 1962 development plan for the purpose of development. This had led to the drain of the country's foreign reserves as a result of increased demand for import. There was a change in policy to credit restraint policy from October 1964 to October 1966 (CBN, 1970). The instruments used were direct credit control, interest rate, moral suasion and variable liquid assets. The results of this policy during this period were the reduction in domestic

credit, a reduction in import demand and an improvement in Balance of Payment (BOPs) position.

Monetary ease policy was re-introduced between November 1966 and June 1969. Moderate monetary restraint policy was introduced in July 1969 and this lasted up to

March 1972[28]. The major economic problem during this period was how to increase domestic production in order to meet the expected increase in demand for goods as the Nigerian civil war was coming to an end.

Monetary ease policy was re-introduced between April 1972 and March 1976. Expansion of domestic production as well as countering inflation was the major concern of the government then (CBN, 1979). This was followed by moderate restraint policy up to December 1981 before the beginning of the stringent monetary restraint policy in 1982. Since 1983 to-date, policy issues were geared towards the conservation of foreign reserve, reduction in the amount of foreign exchange disbursement, discouraging importation, countering inflation and other measures as there was a noticeable recession in the economy[29].

This chapter started with the review of the tools of monetary policy in some developed countries. This was to enable us compare such tools with the prevailing tools in Nigeria. It was followed by the theories built on monetary policy which included the use of interest rates and monetary aggregates. This theoretical framework of monetary policy was concluded by the monetarists and the Keynesians debate on the efficacy of their respective policies. While the monetarists saw changes in the money supply as having direct effect on the level of output, the Keynesians believe that changes in money supply will affect the level of output only if it passes through the interest and investment channels. The two however believed that money affects the level of economic activity.

Some propositions on the theory of monetary policy which include the liquidity argument, the expectation argument are among issues that led us into the development

of monetary policy since the inception of the CBN. It was seen that monetary policy in Nigeria since then was characterised by tight-follow-easy money policy with money supply and interest rate as the major tools. However, the ability of the monetary authority in Nigeria to manage inflation successfully is still in doubt. Most of the papers so far in this area have left out the issue of lags in monetary policy. Few individuals also brought in the issue of our local currency circulating along side with their superior (foreign) counterparts. Efforts are, therefore, being made to discuss the total lags thoroughly and at the same time treat the issue of free inflow of foreign currency with higher value than Naira into this country as the monetary authority in Nigeria are battling to score high marks in monetary management.

Also, researchers into the issue of monetary policy have neglected the activities of the Informal Financial Sector of the economy. The activities of the Informal Financial sector would be looked into in this work to see how it affects the effectiveness of monetary policy.

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CHAPTER THREE

3.0 MONETARY POLICY IMPLEMENTATION IN NIGERIA.

One of the principal functions of the Central Bank of Nigeria is to formulate and execute monetary policy to promote monetary stability and a sound financial system in Nigeria. The C.B.N. carries out this responsibility on behalf of the federal government of Nigeria through the process outlined by the Central Bank itself. The C.B.N. is also empowered to direct the commercial banks and other financial institutions to carry out certain duties in pursuit of the approved monetary policy. Normally, the monetary policy to be pursued is detailed out in the form of guidelines to all banks and other financial institutions. These details could be in form of direct or indirect monetary control to enable the economy achieve various economic objectives.

3.1 PHASES OF MONETARY POLICY IN NIGERIA.

The freedom and flexibility that characterised the Nigerian financial system started when Nigeria got its own central bank and the political independence that followed thereafter in 1960. Between the formative year of the CBN and 1962, the monetary authorities were pre-occupied with the establishment of the domestic financial infrastructure among which were the money and the capital markets. The Nigerian currency (other than the WACB's) was launched at this period. Interest rates and moral suasion were the focusing point of monetary instrument in this period.

Between 1962-64, efforts were made by the policy makers to provide "cheap money" with the hope that the 1962 Development plan could be financed from the available money created. This resulted into BOP problem as the period witnessed higher

demand for imported goods. Credit restraint policy were therefore followed from 1964 up to 1966 with direct credit control, interest rate and moral suasion as the main tools. The policy direction had to be changed when it was noticed in 1966 ending that the economy was not growing. Between 1966 and 1981 therefore, policy issues were characterised by changes from monetary ease to moderate monetary restraint. However, by 1982, stringent monetary policy restraint was adopted. The development of monetary policy in Nigeria shows that a combination of the Keynesian and monetarist's tool has been tested in Nigeria.

3.2 MONEY SUPPLY IN NIGERIA

There has been a considerable increase in money supply since the inception of the CBN except that the rate of increases differ between one period and another. In appendix one, the sum total of money supply (M_2) continued to increase between 1970 and 1993. M_2 increased from about 1 billion Naira in 1971 to 1.2 and 1.4 billion Naira in 1972 and 1973 respectively. These differences are moderate compared to between 1979 and 1980 when M_2 rose from 9.8 billion Naira to 14.4 billion Naira which was an increase of about 46 per cent in just a year. That was the year the military handed over power to the civilian elected government. From 1980, the increase was insignificant if compared to the expected rate of growth in the economy. However, the growth rate jumped again from 24.6 billion in 1986 to about 30 billion and 42.7 billion Naira in 1987 and 1988 respectively. Note that 1986 was the year the policy makers conceived the idea of Structural Adjustment Programme which was meant to terminate in 1988. This

increase continued up to 1993 significantly from 128.3 billion in 1992 to 196.3 billion Naira in 1993.

However, it is pertinent to note that these increases between 1987 to-date is norminal in value due to Naira exchange rate devaluation. Also increase in M_2 seemed not to have any impact on quasi money as shown in appendix 1. Rather, the resultant changes in M_2 from 42.8 billion in 1988 to 46.2 billion Naira in 1989 had led to a reduction in quasi money from 21.6 billion to 20.5 billion Naira in the same year. Although there were noticeable increases in quasi money all over the years under, investigation the increases did not measure up with the increase in M_2.

Increase in currency outside the banking sector was not significant compared to increase in M_2 until after 1988. From the foregoing analysis, the monetary authorities had little or no control over the currency outside the banking sector from 1988.

One issue raised by the monetary authorities was the issue of either low participation of the members of the public in the banking sector or few number of bank branches in Nigeria. Some individuals were of the opinion that financial markets in Nigeria especially the commercial banks are developing. For this reason, few individuals have actually constituted the banking habit.

3.3 INTEREST RATES POLICY IN NIGERIA

Among the various instruments of monetary policy, the most sensitive is the interest rate particularly its appropriate level in a developing economy like Nigeria. The appropriate level of interest rates in Nigeria is a controversial issue. In appendix II,

deposit rate differ between one period and another depending on the time such amount of money were kept in the bank, ranging from 3 months through 12 months and above. Higher deposit rates serve as an incentive for the depositors while low deposit rates discourage lodgement of funds. On an average, the deposit rates obtainable in banks in Nigeria between 1970 and 1981 range between 3 to 5 per cent per annum. It was raised to 9.5 per cent between 1981 and 1986 and raised significantly to 15 per cent in 1987 being the first year of full implementation of SAP. Since then, as a result of deregulation of interest rate, deposit rates increased as much as to 22.5 per cent in some banks in 1992. This created a lot of competition among banks especially between the so called new generation banks of the century. It is worrisome to note that these banks that were giving or allowing higher deposit rates were the newly registered commercial banks and it did not take them years before going into liquidation.

The primary role of interest rates is to help in the mobilization of financial resources and to ensure the efficient utilization of such resources in the promotion of economic growth and development. Interest rate is therefore crucial in financial intermediation which involves transferring funds from surplus units in an economy to the deficit units. In general, interest rates are useful in gauging financial market conditions and they are a major tool of monetary policy in Nigeria. In this, the introduction of wholesale banks into the Nigerian economy needs mentioning. Merchant banking was introduced into the Nigeria economy in 1970 and it was two in 1973. It increased to 5 in 1978, 6 in 1979 through 1981 and grew up to 53 in 1994 with about 116 branches. This study shows that when the Merchant bankers were developing fast, interest rates

policy in Nigeria was a controversial issue to the monetary authorities.

On the average lending rate from 1970 to 1981 was about 9 per cent. It moved to about 12 per cent between 1981 and 1986 and quickly ascended to an average of 17.5 per cent in 1987. The lending rate continued to increase up to 1992 because of the so called deregulation. Although official lending rates in 1992 was said to be about 30 per cent; some commercial banks charged higher. Up to the end of 1993, lending rates increased to an average of about 38 per cent but witnessed a reduction at the beginning of 1994 fiscal period. This may be due to changes in policy direction due mainly to changes in the leadership of Nigeria. Therefore, at the beginning of the 1995 fiscal period, the lending rate was as low as 21 per cent. This regulation that brought down the rate to 21 per cent was the policy adopted at the beginning of 1996 fiscal year but it was noticed that banks were lending even below this rate. As a result of this, the federal government of Nigeria was of the opinion that the market forces were working perfectly and therefore decided to deregulate the interest rates towards the end of this fiscal period (1996).

It was observed that even with the increase in lending rates, borrowers continued to borrow. The Banking system's credit to the economy (Appendix III) 1980 - 1984 shows us this. Aggregate credit to the economy in 1980 was 10.8 billion Naira at an average rate of 9 per cent. When the lending rate almost doubled to (17.5 per cent) in 1987, this did not stop borrowers from borrowing as aggregate credit to the economy that year was 46.9 billion Naira. Commercial banks' share of this credit rose from 9.0 billion Naira in 1980 to 25.9 billion Naira in 1987. In 1992 when the average lending

rate was about 30 per cent, aggregate credit to the economy was 141.7 billion Naira. The year 1993 witnessed the highest average lending rates of 39 per cent in the Nigerian financial system and borrowers still borrowed to the tune of 78.6 billion Naira from the commercial banks and 145.6 billion Naira from the Central Bank of Nigeria (See appendix III)

From 1.7 billion Naira as against commercial bank's 9.0 billion Naira in 1980 CBN's credit to the economy was 145.6 billion Naira as against the commercial banks' 78.6 billion Naira in 1993. Interest rates deregulation during this period (SAP) was meant to allow the forces of demand and supply determine the rate of interest. However, this had not much impact on the liquidity situation of the economy as borrowers continued to borrow at higher rates. Moreso the CBN decided to lend to the priority sector of the economy more money during the deregulation period according to the wishes of the monetary authorities.

3.4 SECTORAL DISTRIBUTION OF COMMERCIAL BANK LOANS.

The issue of sectoral allocation of credit by the commercial banks with the CBN tool of moral suasion is one of the problems affecting the effectiveness of monetary policy in Nigeria. The obtainable major sectors are categorised into 4 with various sub-sectors of the economy for effective application of monetary policy. These are the productive, general commerce, services and others as the four main sectors. Agriculture and manufacturing are presently given much importance when allocation of credit are made and therefore the percentage credit allocation are usually spelt out annually. The

problem here is that the commercial banks until recently usually violates the authorities' guideline. It is for this reason that the CBN's credit officers are allowed to supervise the credit allocation to the farmers in the bank. The banking sector of the economy which comprises mostly of commercial banks are after their profits and therefore tries to deviate from the CBN guidelines on credit allocation.

The maturity structure of commercial bank's loans and advances to the public (see appendix V) is an indication that the financial markets in Nigeria is developing. The Nigerian banking sector does not favour longer term borrowing which allows for reasonable investment, may be due to the growing rate of inflation. Moreover, many borrowers in Nigeria are not credit- worthy or do not have necessary collateral to obtain the much needed credit from the commercial banks. That is why money on call forms a sizeable percentage of commercial bank's loan and advances as shown in appendix IV[31]. In 1980, money on call alone amounted to 3.2 billion Naira out of a total of 6.4 billion Naira of the commercial banks' loan and advances. This means that loans that mature between six months to over five years constituted about half of the sum total of commercial banks' loan and advances at that period. Also in 1992, money on call amounted to about 22.7 billion Naira out of a total of about 42 billion Naira loans and advances of commercial banks to the economy. From 1980 - 94 (Appendix IV) therefore, we could observe that the larger proportion of the activities in the financial markets were undertaken in the money market.

3.5 THE MANAGEMENT OF INTEREST RATE IN NIGERIA.

Among the existing tools for the execution of monetary policy, interest rate is a key tool that can determine the effectiveness of monetary policy. The federal government of Nigeria in recent times has been facing the problem of effective management of interest rate in such a way that could result in the good performance of the Nigerian economy. The theory of monetary management shows us that interest rate enables individuals in the economy to decide when to borrow fund from the financial markets, invest as well as to save.

At the emergence of the CBN, interest rate administration was a direct one where the monetary authority fixed the rates in such a way as to obtain the set objectives. Both the deposits and the lending rates were always fixed by the authorities. This was mainly during the early development of the financial markets in order to obtain set objectives. It is also used for the reduction of the effects of inflation. The preferred sector of the economy are always characterised by lower lending rates to enable the development of small scale industries. This was the case before the introduction of Structural Adjustment Programme in 1986. Therefore the market determined interest rate policy was first introduced in Nigeria in 1987. The market determined interest rates allow banks to determine their deposits and lending rates according to market conditions through negotiations with their customers. Then it was agreed that the minimum Rediscount rate (MRR) which had an effect on other interest rates continued to be determined by the Central Bank of Nigeria. This varies between years and it depends on the prevailing economic situation and wishes of the monetary authorities. At deregulation therefore, the MRR fluctuated between 15 per cent and 12 per cent so as to stimulate investment

and subsequently, growth.

The re-introduction of direct control of interest rates by General Sani Abacha's regime in 1995 was an indication that the market determined interest rates policy which started in 1987 was not serving the purpose. This was because with the deregulation that brought about higher interest rates, domestic credits to the economy was still high. This may not be unconnected with the existing domestic inflation or expected inflation. The borrowers were therefore of the opinion that expected inflation could boost business activities resulting in higher profit that could offset the higher rate of interest. Therefore interest rate as a tool of monetary policy may not be very effective during the period of inflation in an economy. This should be the main reason for the government intervention in the interest rates policy of today. The developing financial market an imperfect one to some extent is also a strong reason for government intervention in the prevailing interest rate that could possibly stem the economy.

The regression result

The model testing the relationship between interest rate and the banking system's credit to domestic economy has the following results:

$$AC = \underset{(-0.76)}{-360} + \underset{(2.73)}{58.5r} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

$R^2 = 38.3\%$; $R^{-2} = 33.1\%$; DW = 0.79

$$AC_t = \underset{(-0.44)}{-188} + \underset{(2.65)}{51.8r_{t-1}} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2)$$

$R^2 = 36.9$; $R^{-2} = 31.6$; DW = 0.71

$$CPS = -121 + 31.9r \quad \text{..... (3)}$$
$$(-0.54)\ (3.7)$$

$R^2 = 45.6;\ R^{-2} = 41.1;$

$$CPS_t = -31 + 28.4r_{t-1} \quad \text{..... (4)}$$
$$(-0.15)\ (3.10)$$

$R^2 = 44.4\%;\ R^{-2} = 39.8\%;$ DW 0.93.

$$CGS = -833 + 112r \quad \text{..... (5)}$$
$$(-0.84)\ (2.49)$$

$R^2 = 34.0;\ R^{-2} = 28.6\%;$ D.W. 0.69

$$CGS_t = -500 + 98.5r_{t-1} \quad \text{..... (6)}$$
$$-0.56\ (2.41)$$

$R^2 = 32.6\%;\ R^{-2} = 27.0;$ D.W. 0.63

$$CCB = -1649 + 207r \quad \text{.....(7)}$$
$$(0.99)\ (2.74)$$

$R^2 = 38.5\%;\ R^{-2} = 33.4;$ D.W. 0.76%

$$CCB_t = -1023 + 182r_{t-1} \quad \text{.....(8)}$$
$$(-0.67)\ (2.64)$$

$R^2 = 36.7;\ R^{-2} = 31.4\%;$ D.W. 0.68%

From the results in equations one to eight, we observed the following.

i) The relationship between interest rate and borrowing is positive as against

the rule of negativity. This means that the increase in the rate of interest due to interest rates deregulation did not stop borrowers from borrowing. It does not lead to reduction in borrowing.

ii) Our co-efficient of determination in equations one to eight has a minimum of 34 per cent and the maximum is 45.6 per cent. This means that the rate of interest is not a strong determinant of credit demand in the Nigerian economy. To crown it all, the lagged model had a lower co-efficient of determination than the original model (see all odd number equation results).

3.6 MANAGEMENT OF INFLATION IN NIGERIA.

The effectiveness of monetary policy could not be judged or looked into without first considering how well the monetary authorities in the country have been able to tackle inflationary process in Nigeria. Traditional economic theorists are of the opinion that changes in money supply are the main causes of increase in prices.

Appendix 5 shows the percentage increase in money supply and inflation rate between 1970 and 1994. From 13.8 per cent in 1970, inflation rate in Nigeria became 15.6 per cent in 1971. It was noticed that a higher percentage increase in money supply was witnessed between 1973 and 1977. This was the period of oil boom. In 1975, percentage increase in money supply was as much as 73.5 per cent while inflation rate for the same year was 33.9 per cent. Thereafter, money supply increased at about 6 per cent in 1978. However, in the year 1980 percentage increase in money supply was about

50 per cent. Inflation rate for the same year was about 10 percent but the preceding year with about 5.6 per cent increase in money supply witnessed an inflation rate of about 21 per cent (see appendix V).

Inflation problem in the economy continued where we have a higher rate of 39.6 per cent in 1984, 38.3 per cent in 1988 and as high as 40.9 per cent in 1989. Measures both monetary and fiscal operations taken during these periods to curb inflation did not have impact on the rate as we recorded 44.5 and 57.2 per cent inflation rate in 1992 and 1993 respectively.

One of the policy measure taken to correct the inflationary trend in the economy was to stop deficit budgeting in the economy. Therefore, the economy had been operating budget surpluses since the past three years. Despite the budget surplus which Nigeria recorded about 36 billion Naira at the end of the 1996 fiscal period, prices also went up in the same year; also it was noticed that the rate of inflation was relatively low.

Another reason that was associated with the inflationary trend in Nigeria was the past government policy on wage increase. The in-coming of a civilian administration in 1979 marked another beginning of demand management problem as wages were then freely allowed to increase so as to boost effective demand for goods and services. It was during this civilian era that the government of Nigeria witnessed a higher level of importation of goods and services. Also the era of President Babangida marked the beginning of wage rate deregulation. As at now, the gap between the public sector and the private sector remuneration to employees is wide. To worsen the whole situation, some parastatals are allowed to fix their wages on the basis of their so called ability to

pay. Wage rate differential is therefore one of the reason for the inflationary problem in Nigeria today.

3.7 MAJOR USEFUL TOOLS OF MONETARY POLICY IN NIGERIA.

Managing an economy entails articulating well meaning strategies and devising various policies and measures that ensures efficient utilisation of the nation's available resources. This is with the view of promoting economic growth and employment as well as maintaining domestic and external sector stability. The techniques by which the monetary authority tries to achieve these objectives can be classified into two categories - the direct and indirect market approach.

The direct method which is always employed mainly in developing economies in which the financial infrastructure necessary for operating indirect approach is absent are quantitative ceiling on bank credits, selective credit control, administered interest rate and exchange rates. The Indirect method which is associated with the developed financial systems relies on the power of the monetary authority as a dealer in financial markets to influence the availability and rate of returns on financial assets. This affects both the desire of the public to hold money balances and the willingness of financial agents to accept deposits and lend them to the users. Therefore, some of the indirect tools are reserve requirements, discount rate and open market operation. It is better we briefly look at each of these.

3.7.1 THE DISCOUNT RATE AND THE INTEREST RATE STRUCTURE IN NIGERIA

A discount rate is the rate of interest the Central bank charges the commercial banks on loans extended to them. On the other hand, interest rate is the price of capital to the borrower and a return on capital to the saver or lender. As more has been said on interest rate, we are here concentrating on discount rate.

The ability of monetary authority to use discount rate to control the liquidity in the economy depends on the speculators. As the speculators are expecting a brighter future for the economy, it is expected that the discount rate could be effective. However, if the discount rate is fixed by the CBN at a rate that the Commercial banks could borrow and obtain a higher profit, then the discount rate will not be effective. Moreover, it has been said that the commercial banks who are after their profit margins do not always co-operate with the federal government. This lack of co-operation with the federal government had rendered interest rate deregulation ineffective in controlling the liquidity in the economy. In this situation, the higher the discount rate the higher the commercial banks fix their interest rate. And in an economy with expected inflation, the higher interest rate had not deterred the members of the public from borrowing from the commercial banks.

3.7.2 SELECTIVE CREDIT CONTROL INSTRUMENT

Credit ceiling and selective credit control are the principal means of directly influencing bank credit operations in Nigeria. The CBN also has power to prescribe minimum ratio of loans and advances which the commercial banks should grant to indigenous people or persons. There is also a requirement that bank application exceeding a specific amount should be submitted by the commercial banks to the CBN

for approval. Also, there is an associated power of the Central Bank on the commercial banks on issues of sectorial distribution of credit. Legal sanctions have been provided to deal with bank's failure to comply with the Central bank's monetary policy directives. How effective has the sanction on the Commercial banks been?

Administered exchange and interest rates are other direct monetary policy tools that come in mind here. The issue of exchange rate has to be treated separately as a chapter. This is because it is one of the problem areas that is linked with the associated monetary policy issues in Nigeria. Till today Nigerian monetary authority cannot determine a realistic exchange rate.

3.7.3 RESERVE REQUIREMENT AS A TOOL OF MONETARY POLICY

The reserve requirement otherwise known as the reserve ratio can also be manipulated by the monetary authority to reduce the ability of Commercial banks to make loans to the public. It is expected to be one of the powerful instruments of monetary control. This is because, a change in reserve ratio changes the ratio by which the banking system can expand deposit through the multiplier effect.

Cash reserve requirement was first used between 1972 and 1976 precisely to reduce excess cash holdings by the Nigerian Commercial banks (Otiti, 1982) Then, the Commercial banks were expected to maintain a minimum cash deposit of 5 to 12 per cent of their total demand and time deposits with the CBN on which they are paid interest rate of 2½ per cent. It has been argued that cash reserve ratio is redundant as it is already part of the liquidity ratio which the CBN is empowered to vary in terms of its composition and component amount (Teriba, 1977).

The Central bank's power to call for special deposits from the Commercial banks has similar brunt effect on Commercial bank liquidity as the cash reserve ratio. Such funds are usually frozen in the CBN and therefore unavailable for credit creation. Another name for this type of fund required to be deposited with the CBN is the Stabilisation Security deposit.

3.7.4 OPEN MARKET OPERATION AS A TOOL OF MONETARY POLICY

Open Market Operation (OMO) is conducted mainly in the secondary market for government securities through its buying and selling by the CBN. By so doing, it is expected that the Central bank directly changes the levels of bank reserves and indirectly induces changes in the level of interest rates, the terms and availability of credit and the volume of money supply. In a simple form, the CBN sells government securities to the banks and the public to reduce the volume of money supply in Nigeria while it buys to increase the volume of money in circulation.

Before the introduction of SAP, the CBN relied solely on direct monetary control of the volume of money in circulation. However, the CBN was not comfortable with the outcome of direct monetary control although there were said to be no alternative given the constraints of the developing financial sector. For one, the CBN found the credit ceiling increasingly difficult to achieve the stated monetary targets. The credit ceiling also encouraged inefficiency in the banking system. This protected the weaker banks while limiting the growth of the efficient banks.

The eligible instruments of OMO are treasury bills, treasury certificates and

elegible development stocks and other useful money market instrument (See appendix VII).

At present, the CBN conducts the OMO through the discount house system while the weekly auctions at the primary market remains open to the authorised dealers like discount houses, commercial and Merchant banks. The schedule to meet with the discount houses are made by the CBN at regular intervals.

Notice by the CBN to sell securities in order to releive the surplus in the market is always given to dealers in writing. In this notice there could be the stated amount, the instrument and the maturities. The submission of the dealers are however made to a discount house which makes bid to CBN. Usually, the CBN accepts those bids with lowest discounts while the discount houses allocate the bids accepted by the CBN to bank bidders at each bank's bid rate. The buying of securities by the CBN to replenish shortage of fund is with invitation of the dealers showing the discount rate at which the bills are being offered. In this case, the CBN has the discretion as to which offer to accept and usually it accepts offers with the highest discount rate up to the amount of offer. The method of payment to effect the transfer of securities is by direct debit after the parties involved in the transfer have appended their signatures on the transfer forms.

Open Market Operation, which is a recent indirect monetary control in the Nigerian economy, has made a substantial progress in creating a conducive environment for the financial sector according to Ezeudiji. Most importantly, the financial system had been adequately deregulated (EZEUDIJI 1993). However, the recent monetary policy statement accredited to the Finance Minister was that there would be a guided

deregulation in all sectors of the economy. At the beginning of the 1997 fiscal period, the interest rate was regulated at 21 per cent. But recently, it was said that the government intended to deregulate the interest rate.

Open Market Operation had also promoted the rapid growth and number of banks in this country as part of the achievement. Many banks were in operation just to market the existing securities and the foreign exchange. However, many banks are in distress today. Also the money market is constrained by a number of inadequacies which are not favourable to OMO. This is mostly because of the existence of the Informal Financial Sector (IFS) operating side by side with the formal financial sector of the Nigerian economy. Some are of the opinion that there are inadequacies of the Formal Financial Sector but the real issue is that there has been lack of banking habit and confidence among the Nigeria people; a situation that may render OMO ineffective and the policy as well. Also, the OMO has to be patronised for the effective implementation of the system. Nigeria being a developing economy with a yearly higher level of inflation should surely find the operation of buying and selling of bonds impossible. With this inflation rate, the level of participation of government bonds is always low. Also the existence of many unorganised money and capital market as a means of acquiring more money had rendered the operation of OMO not feasible in this economy. Expected inflationary trend had made the participation of the public to be low no matter the expected yield. The rate of returns on financial assests are also more than that obtainable from the OMO.

CHAPTER FOUR

4.0 THE PERFORMANCE APPRAISAL OF THE FINANCIAL MARKETS IN NIGERIA.

The Financial markets in Nigeria are institutional arrangements that facilitates the intermediation of funds in the Nigerian economy. The operation of the financial markets in Nigeria could be traced back to the period or immediately after the establishment of the CBN. These financial markets are a combination of both the money and capital markets in Nigeria. The difference between the money and capital markets in Nigeria is in the degree of liquidity of instruments bought or sold in each market. How the operations of these markets affect the effectiveness of monetary policy could be studied by looking at individual market and their operation in Nigeria.

4.1 MONEY MARKET AND MONETARY POLICY IN NIGERIA

The initial operation of what was called the money market of this country was from the London money market. That is to say that the surplus spending units have no market for their excesses in Nigeria but in the London money market. If there was, it is mostly foreign dominated because most of the bankers that were in operation in Nigeria were instituted by the foreigners. The money market was considered necessary for Nigeria then to provide the necessary conditions for government short-term financing for the development of the economy.

The debt instruments traded in the money market included treasury bills, treasury certificates, commercial papers, certificate of deposits, promissory notes, money at call, to mention just few. The participants in this market or the market customers include,

commercial banks, merchant banks, insurance companies and any other type of saving institution.

Official records in respect of the operation of treasury bills were as far back as 1960 (see appendix VII). Then (1960), treasury bills outstanding were about 18 million Naira while commercial papers were only about 2 million Naira. Treasury bills continued to increase as a debt instrument and recorded 168 million Naira in 1967. However, the increase in Commercial papers up to 60 million Naira in 1966 was slowed down to 36.4 million Naira in 1967. It was further reduced to about 5.1 million Naira in 1968. The slowing down of the use of Commercial papers may not be unconnected with the development of the money market.

Between 1970 and 1977, treasury bills outstanding as instruments in the money market seemed to have stabilised. From 556 million Naira in 1970, the highest in that period was 619 million in the year 1977. If compared with the period between 1980 to 1987, there was a significant increase of treasuring bills in the 1980s than in 1970s. From about 2 billion Naira in 1980, treasury bills outstanding amounted to about 13 billion Naira in 1983, 15 billion Naira in 1984 and about 25 billion Naira in 1987.

Debt instruments like Certificate of deposit, (CD) Eligible Development stocks, (EDS) and Bankers Unit Fund.(BUF) were not officially in use in the Nigerian money market until 1975. These CD, BUF, and EDS, amounted to about 50 billion Naira in 1975 out of a total of about 984 million Naira money market assets in the same year.

From about 2 billion Naira in 1990, the CD, BUF and EDS were drastically reduced to about 1.1 billion Naira in 1991. It further went down to about 536 million Naira in

1992 and dropped further to about 100 million Naira in 1993. (see appendix VII).

The use of treasury certificates was as far back as 1968 with a total asset of 20 million Naira in the same year. The following year (1969) it went up to 142 million Naira. A point to note is that the treasury certificates was able to hit a billion Naira value earlier before Treasury bills which started far earlier than the treasury certificates. However, its rate of increase was slower than that of treasury bills. As at the end of the 1993 fiscal period, treasury bills outstanding amounted to about 103 billion Naira while treasury certificates recorded about 36 billion Naira in the same year.

The total assests of the money market which was 20.3 million in 1960 amounted to 122 million Naira in 1965. It was about 984 million Naira in 1975. With about 12 billion Naira in 1982, the total assets money of the market in 1991 amounted to 93 billion Naira in 1991. As at the end of the year 1993, the total assets of the money market outstanding was about 145 billion Naira.

From the foregoing analysis, the money market operation was nominally increasing in assets. However, the instability in values between one period and another was an indication that the money market was developing. Fluctuations in the development between the debt instruments was an indication of lack of confidence on the part of the participants between a period and another. This could be seen from the reduction in the value of commercial papers between 1968 and 1973.

The holdings of treasury bills and treasury certificates outstanding as instruments in the money markets is another area that could be looked into. As at 1960, the holdings was dominated by individuals and firms or organisations. Then these category otherwise

known as 'others' constituted about 64.3 per cent of the total holdings. But as the money market grew, there was a shift from others to Commercial banks and the CBN as the principal actor. (see appendix VI). The CBN which had 15.2 per cent of the holdings in 1960, held about 83 per cent of total holdings in 1992. Commercial banks holdings of both treasury bills and treasury certificates reached its highest climax in 1975 with about 87 per cent of total. The CBN was in the same year holding only 0.5 per cent of treasury bills and treasury certificates.

The shift of emphasis from the CBN to Commercial banks and vice versa could not be unconnected with the underdeveloped nature of the money market as seen in appendix VI. The Government's participation in this case was only much noticed between 1971 and 1973. It could be seen from the data that there was little or no government participation in treasury bills and treasury certificate between 1982 to-date.

The foregoing analysis shows that the money market had expanded in the past years and is still expanding. It is pertinent to note that during its period of expansion, the financial services sector especially the Commercial and Merchant banks, had developed and is still developing. There is also the issue of interest rates regulation and deregulation which also had its effects on the development of the money markets. Although there were noticeable increases in the banking sector in terms of the number of banks in the economy, the level of the participation of members of the public was low.

Interest rate which serves as an incentive for credit mobilization is presently not an effective tool for credit mobilisation possibly because of expected inflation.

4.2 THE NIGERIAN CAPITAL MARKET

A capital market as noted earlier is the market for dealings in Long-term loanable funds. The market is always known to be the source from which the government and members of the public borrow from. Just as in the money market, the capital market in Nigeria existed as far back as the early 1960s. Precisely, government participation in the capital market and the industrial shares, the Nigerian Industrial Development Bank as well as the stock exchange were established in 1959. The Nigerian Agricultural and Co-operative Bank (N.A.C.B.) and the Nigerian Security and Exchange Commission came into being as an organ of the capital market in 1973. Many other institutions were established but we are much interested in the few mentioned ones for the purpose of this work. The loan instruments traded in the capital market are equities or ordinary shares, federal government stocks, state government bonds, company bonds, debentures and mortgages. The participants include Commercial banks, Merchants and Development banks, finance and insurance companies, provident and pension funds and many other financial intermediaries. As the Commercial banks dominate the money market, the non-bank financial institution are the major participants in the capital market.

4.3 OPERATION OF THE NIGERIAN STOCK EXCHANGE

Until 1977, there was nothing called the Nigerian Stock Exchange in the Nigerian capital market. Rather, the general name was the stock Exchange which started operation in 1961 and was re-named the Nigerian Stock Exchange in 1977. As it is part of the capital market of many countries, the Nigerian Stock Exchange was established

to perform the following functions.

(a) To provide a meeting place for dealings in stock for buyers and sellers of stocks and shares which encouraged the raising of new capital from the market;

(b) to facilitate the dealings in government securities to enable government raise fund for the purpose of development;

(c) to provide the machinery for the mobilisation of private and public savings for productive investment through stocks and shares;

(d) the institution of a formal stock exchange protect the public from shady deals source. The institution puts confidence in the mind of the public to participate without fear.

Appendix VIII shows the transactions in the Nigerian Stock Exchange between 1961 and 1993. At the inception of the stock exchange in 1961, the total transactions in number was 334 with industrial recording the highest number of 242. The total value in Naira amounted to about 1.5 million Naira. Four years later (in 1965) total number of participants was 1,018 amounting to about 15.8 million Naira. However, the total number of participants reduced between 1967 and 1973. From 763 participants in 1967, the number of participants in 1973 were 819. Although the number of participants did not significantly increase compared to other periods, the value in Naira increased.

In 1967, the Nigerian Stock Exchange was valued at 12.4 million Naira but amounted to 92.4 million Naira in 1973. A point to note is that although the number of participants in the industrial stocks were higher, the value in Naira was not comparable

to that of government. In 1975 for example, the government participation in bonds numbering 193 amounted to 63.7 million Naira compared to industrial number of 501 participants which amounted to about 0.6 million Naira.

The year 1986 was the year the government's participation attained its peak for the studying period both in number of participants and value in Naira. In that year the government participation was 270 in number while industrial participation numbered about 27 thousand participants. The value of government's participation in the same year amounted to 475.6 million Naira while industrial participation amounted to 20 million Naira. One could notice from the given data (Appendix VIII) that the government's participation had been decreasing both in number and in value since 1986 and that this trend had continued up to 1993.

The Securities and Exchange Commission (SEC) which was the first regulatory organ of the Nigerian capital market needs mentioning. The SEC which was formerly called the capital issues commission was established in 1979 for the purpose of providing a conducive atmosphere for savings and investment necessary for development. The SEC was also vested with the responsibility of ensuring fair and appropriate price of stocks and shares as well as protecting the investing public. As at 1993 the SEC's activities included the overseeing of activities in the capital market in such a way as to ensure orderly conduct of transactions.

The other development in the Nigerian capital market was the introduction of the Second-Tier Security Market (SSM) in 1985 by the government of Babangida. The SSM was meant to serve the interest of small and medium size enterprises that needed to raise

capital through the stock market. The SSM is also expected to facilitate the overall growth of the market especially in expanding the number of securities available for transaction in the market. The SSM was able to contribute to increasing the number of stocks available for transactions in the capital market. This perhaps is the main reason for higher industrialists participation in stock despite the continued decrease in the number of government's participation. However, the medium size enterprises found it difficult in meeting the stock exchange's requirements which were said to be stringent.

Another area that needed mentioning is the federal government's Structural Adjustment Programme (SAP) which was implemented in 1986. It affected the capital market in the area of the privatisation and commercialisation of public institutions in Nigeria. This commercialisation and privatisation have resulted in the increased awareness of the members of the public about the opportunities in the stocks and shares market. The issue of buying and selling of government share was dominant in the SAP policy before it was put to rest at the beginning of the 1990 fiscal period. Since then, little talk are been made about issues of selling government shares especially in key federal institutions. However many government shares were sold out for public participation to bring about efficiency in the management of resources.

One of the major problems of the Nigerian capital market according to Onyido (1994) was that the capital market was characterised by infrastructural inadequacies. That there are delays in affecting transactions between issuing houses, broker, investors and their banks due to inefficient postal and telegraphic services. This therefore means that the market is a developing one that could hinder the effectiveness of monetary

policy.

The other problem is the lack of awareness among the public especially the richer public to invest in stocks and shares. There is also the reluctance on the part of the Nigerian business men in going public for fear of a possible takeover by the participants. This could be the reason why government securities dominated the Nigerian stock exchange market as seen in appendix VIII.

Apart from the awareness of members of the public, it does not sound profitable to invest in shares and stocks with the existing inflationary trend in the economy. Before any reasonable earnings are attached to such investment according to the members of the public, such money should have yield better incomes through other organised or unorganised means.

4.4 THE NIGERIAN BANKING SECTOR AND MONETARY MANAGEMENT

Commercial banking institution predates central and merchant banking institutions in Nigeria. The two broad functions of the commercial banks that affect monetary policy are:

1. The creation, distribution and transfer of deposits as well as the provision of credit necessary for the effective functioning of the economy;
2. The savings function which comprises the mobilisation of savings from the surplus spending units of the economy and channelling it to the deficit spending unit and capital projects for the purpose of economic

development.

To supplement the functions of the Commercial bank, the whole sale banks other wise known as the Merchant banks, were established. The first one to be set up was the Nigerian Acceptances Limited (NAL) in 1960.

The number of Commercial banks in Nigeria in 1970 were 14 with only one Merchant bank (see Appendix XII). Ten years later (in 1980) the Nigerian economy has 20 commercial banks with only 6 Merchant banks. At the end of the 1990 fiscal period, the number of commercial banks rose to 58 with 49 merchant banks. At this period so many commercial banks were in difficulties which arose from liquidity problems. However, the number still increased to 66 Commercial banks in 1993 with 53 Merchant banks. It was viewed that the proliferation of the banking services could promote an effective payment system in such a way as to make monetary policy effective as funds could be channelled through the existing financial system.

4.5 THE ISSUE OF DEVELOPMENT BANKS IN NIGERIA

The Federal government of Nigeria conceived the idea of specialised development banks in Nigeria so as to serve the needed development purposes. For this reason, the Nigerian Industrial Development Bank (NIDB) was established in 1959 but set up in 1964 to provide credit and other facilities to industries. To promote the Nigerian enterprises at the local level, the Nigerian Bank for Commerce and Industry (NBCI) was set up in 1973 to provide financial services to indigenous business community, particularly, the small and medium scale enterprises. The Nigerian

Agricultural and Co-operative bank (NACB) was established in 1973 with the hope of financing agricultural development projects and allied industries. The Federal Mortage Bank of Nigeria (FMBN) was established in 1977 with the function of controlling and supervising mortgage institutions in Nigeria as well as providing guarantee for loans from private investment sources for building purposes both in the rural and urban areas.

The People's Bank of Nigeria (PBN) Commenced operations with the initial deposit of 30 million Naira to serve the purpose of low income earners. Precisely, it was meant to provide credit to the low income earners without collateral and interest rate but with low administrative charges. A borrower is expected to be a member of group of 15 people with a repayment period of 50 weeks. The whole thing about PBN was abused both by the staffer and the members of the public. It was characterised by corruption and embezzlement as well as many defaulting repayments.

The federal government of Nigeria decided to institute the Community bank in the 1990 Budget. It was expected to be a self-sustained financial institution which was expected to be owned and managed by a community or group of communities. The community banking sector of the financial system proliferated in Nigeria to the extend that many communities opened up their respective community banks.

However, this supply-leading policy of financial development did not convince the public much for banking habit formation. In many cases, these community banks developed liquidity crises to the extend that those who deposited money were unable to withdraw and many people ran from the Community banks.

The institution of these development banks was a major development in the

Nigerian financial system but many have failed to serve their respective purposes. Issues regarding the operations were politicised. For one, the NACB which was to give loans for agricultural development, sometimes gave out loans to non-agriculturalists. Such fund been diverted outside the agricultural system do affect government policy negatively.

The Nigerian financial system had developed in a supply-leading policy especially in the financial markets to serve the purpose of managing the economy through the banking sector. However, the lack of confidence in the banking sector brought about by the development in the banking sector coupled with higher inflationary trend and expected inflation, had deprived the banking sector of the expected liquidity. The resultant outside-the-banking-sector-money had rendered monetary policy tools ineffective.

4.6 THE INFORMAL FINANCIAL MARKETS IN NIGERIA

So far, the discussion of monetary policy was concentrated on the formal financial sector (FFS), that is, the Commercial banks and various specialised financial institutions. But the issue of monetary policy in a developing country, could not be completed without mentioning the Informal financial Sector (IFS) existing in the developing country like Nigeria. The respective customers in both formal and Informal financial sectors are formal and informal customers respectively.

This study of the informal financial sector shows that there are two groups identified. The first one which might be called "Self help savings and lending schemes"

rely on the mobilisation of savings within the rural and urban informal sector to provide the capital for loans. One important group that comes to mind here is the so called Rotating Savings and Credit Association (ROSCAs). The second group involves institutions that operate independently of the Commercial banks but which may or may not be linked with the FFS. The money lenders is an example that could be drawn from the second group. Evidence shows that there are varieties of these two mentioned groups operating mostly in rural areas with similar aims and objectives except that their mode of operation may differ between one geographical place and another.

4.6.1 SELF-HELP SAVINGS AND LENDING SCHEMES

This need is met by the formation of group of individuals in association to pool their savings together in order to provide loans. The Rotating Savings and Credit associations (ROSCAs) is an institution that is found among the Nigerian people especially among the market women. The method of ordering the rotation is determined in several ways. In some cases, hierarchies are important. The order may depend on seniority or social standing. In other cases, it is determined by lot. ROSCAS does not attract any rate of interest. In most practicable societies, those that receive the credit use it for the purpose and so the idea of taking the money to the bank is not there.

One of the major problems associated with ROSCAs was the case of defaulting by members who have collected. The defaulting member may either refuse or may be unable to contribute to others because of one problem or the other. Note that collateral is not provided to safe-guard the scheme. However, if the groups are homogenous such

as neighbours or fellow workers, the rules of the entry may be strict enough that there could be little or no case of default by any member. The ability of any ROSCAs to serve its purpose of mobilising fund for members depend on the number in the group or size of the group, the size of contributions, the length of the circle and the method of rotation adopted. Large size in terms of membership is always boring as it may takes years for the circle to complete. In this case, the inflationary trend between the starting period and the end of the circle may serve as a discouragement to members receiving or benefiting from the scheme in a later period.

4.6.2 THE INFORMAL LENDING INSTITUTION

Among sources of credit that do not involve savings commitment is the money-lenders which have been the traditional source in many poor communities in Nigeria. Judgements concerning their operations vary between one community and another or between a rich person and another. The freedom of entry is conditioned by the need to obtain the information necessary to assess the credit worthiness of the borrowers which is essential in the absence of collateral.

One thing to note in this informal lending institution is that the money lenders never allow their money outside the system for so much longer period of time. In other words, this takes place in an informal money market.

Another area that makes this institution different from other informal financial sector is that the rate of interest is always very high. In some cases, the rate of interest could be about 10 to 15 per cent per month - on any borrowed fund. According to

Shaila (1993) the close proximity of money-lenders to the borrowers can reduce transaction costs and use of resulting knowledge obtained by this proximity can provide an assessment of risk that enables them to charge a risk premium, which replaces the demand for collateral by other lenders. This was the argument made in favour of higher interest rate charged by money-lenders than those charged by the FFS.

4.7 INFORMAL FINANCIAL SECTOR AND MONETARY POLICY IN NIGERIA.

Financial dualism involves the dichotomy between FFS and IFS and how this affects monetary policy of a country depends on their respective operations in the financial system. While the customers of the FFS tend to be in the modern sector of large-scale industrial and manufacturing production, there are also rural customers in the rural agricultural sector participating in both FFS and IFS.

To evaluate the relevance of financial dualism for monetary policy in a developing country like Nigeria, it is necessary to estimate the size of the IFS. This is difficult since the unregulated nature of the IFS means that statistical data are not available for use. Such use of quantitative data, if available may relate to different dimensions of the IFS such as the proportion of the population that participates in the IFS and possibly the value of transactions in IFS. However, it is possible to shed light about what effects monetary policy measures have on the IFS and its customers.

Monetary policy which could control the volume of credit in the FFS has little or no effect on the provision of credit in the IFS. Studies according to Sheila (1993)

indicated that a sizeable percentage of agricultural loans in developing countries were obtained through the IFS. And when the policy does not have the ability to control the level of credit in the economy, it then means monetary policy may be found to be ineffective in Nigeria. As the CBN is regulating the volume of credit for example, the IFS is not under the direct control of the CBN and therefore render this aspect of monetary policy ineffective. Moreover many of these money lenders were rich capitalists that do not believe in the existence of the commercial banks and therefore leave their money in the home saves for lending out to the members of the public. This is a leakage in the financial system and the existence of this type of leakage renders monetary policy ineffective. Moreover, as the CBN has no control over the credit volume in the IFS, some of the monetary policy tools are therefore not effective or not in use at all. The tools like moral suasion which is expected to direct credit into the priority area of the economy is also not in use. This is because a typical money lender may not be interested in the use that the borrower is going to put the money into. All such money lenders may be interested in, is how to get back his or her money along with the rate of interest. Although there are no statistical evidence to show the level of public participation in the IFS, everyone knows that this is existing in the Nigerian economy.

CHAPTER FIVE

EXCHANGE RATE MANAGEMENT AND THE EFFECTIVENESS MONETARY POLICY IN NIGERIA

INTRODUCTION

Foreign exchange according to encyclopedia of Social Sciences "designate the entire mechanism by which payments and receipts between two points or areas operating under different currency systems are affected without the passing of actual money or articles having intrinsic values". It is simply a means of payments for international transactions. Developing countries like Nigeria require foreign exchange reserves to be able to meet the demand for imported goods and services for the entire country. It is for this reason important for the development of a country where its effective management could lead to the effective management of the economy as a whole.

The need for exchange rate management arises as a result of short-fall in the supply of foreign exchange relative to its demand in the country. Therefore, good management of foreign exchange brings about the most wanted equilibrium demand and supply situation for the rate of exchange that could protect the infant industries and at the same time maintain the par value of the national currency.

The history of exchange rate management in Nigeria dated as far back as 1962 when exchange control regulations formulated by the Bank of England were circulated to all Exchange rate control authorities in the Pound sterling areas (Olalokun, 1979). It was designed to check and forestall the balance of payments crises in Nigeria. The 1962 exchange control Act was later characterised by abuses by the authorised dealers which resulted into the enactment of Exchange control (Anti-Sabotage) Act of 1977. The CBN

then allocates foreign exchange daily to authorised dealers on the basis of demand and supply of foreign exchange.

Some major important reasons that are in favour of effective management of foreign exchange in a developing country like Nigeria as it affects monetary policy are:

(i) The allocation of foreign exchange to the priority sector or sub-sector of the economy for the mutual benefits of the people;

(ii) The maintenance of confidence in the financial system of the economy;

iii) The maintenance of par value of Naira (national currency) in relation to other currencies in such a way that this does not have an adverse effect on the national currency;

Various theoretical backgrounds informed the monetary authority's mode of operation in the management of exchange rate in Nigeria. Here, we are concerned with the monetary approach which emphasised the role of money in shaping other aggregates that influence foreign exchange movement and international reserves. The monetary approach assumes that when exchange rate is fixed, the monetary authorities can control the foreign or international reserves components of monetary base through appropriate credit policies. On the other hand, under floating exchange rate, money supply is exogenous and as such can be controlled. The important issue in fixed exchange rate is that international or foreign reserves have to be adequate to protect the fixed rates but the need for reserves diminishes when exchange rates are allowed to float. The Nigerian monetary authorities since the inception of the CBN, have used both the fixed exchange rate and the floating exchange rate system to achieve various desirable economic

objectives. Specifically, the administrative approach was used between 1962 and 1986 before the Naira was made to float to enable it find its level beginning from the year 1986.

5.1 FOREIGN EXCHANGE MARKET UNDER SAP

Exchange rate management under SAP was characterised by a kind of trial and error policy which started in 1986. By September 1986, the Nigerian currency was floated against other foreign currencies with the introduction of the Second-Tier foreign Exchange Market (SFEM). This system employed auctioning to clear the market with weekly bidding. By October, 1986, the bidding was changed to fortnightly. By March 1987, the monetary authorities in Nigeria introduced the daily bidding. Months from then, there was an introduction of the Dutch Auction for fortnight bidding while the first and second-tier markets were merged in July 1987 for fortnight bidding.

By January, 1989, another clause was introduced into this market called Inter-bank Foreign Exchange Market (IFEM) which succeeded the autonomous market. These developments led to the continued depreciation in the Naira exchange rate in favour of foreign currencies. The Bureaux de change - the licenced foreign exchange dealers - were formally allowed to operate in Nigeria in 1989. This period witnessed the proliferation of Commercial banks each trying to just buy and sell foreign exchange for profits.

Possibly, the market-determined system introduced in 1986 has not been in favour of Naira. This is because, the Naira which was more valuable than the Dollar since

1973, had depreciated since its period of floating. From 1973, the year the Nigerian government changed from the Nigerian Pound to Naira, less than seventy kobo was then exchanged for one U.S Dollar. However, the Naira exchange rate depreciated continuously with changes in exchange rate policies between 1986 to-date (see appendix IX). From about four naira and fifty kobo to one US Dollar in 1988, seven Naira and fifty kobo was been exchanged for one Dollar in 1989. Whereas 8 Naira was exchanged for 1 pound sterling in 1988, the pound sterling exchange rate became 11.8 Naira in 1989. The gap between the Naira and other superior foreign currencies continued to widden up to 1990 when between 8 and 16 Naira were exchanged for a Dollar and a pound sterling respectively. The continued depreciation of Naira resulted in a change of policy to what was called the modified Dutch Auction System (MDAS) by august 1991. The CBN at that period was trying to Mop-up excess liquidity in the economy with the issuance of large volume of stabilisation securities (Olisadebe 1991). Banks were then asked to debit the account of any customer buying foreign-exchange immediately with the Naira value equivalent of their foreign exchange demand. The CBN became the determinant of the buying and selling rate of foreign exchange.

These policy measures were meant to raise the efficiency rate of the foreign exchange market through the direct effects of the Naira exchange rate with the hope of stabilising the exchange rate. However, by 1992, about seventeen Naira were being exchanged for one U.S. Dollar and twenty seven Naira for one Pound Sterling. At the end of the 1993 fiscal period, twenty-two and thirty-two Naira were exchanged for a Dollar and pound sterling respectively. As at that period, the government felt that the

exchange rate should stabilise at twenty-two Naira to one U.S. Dollar and decided to maintain this as a policy. But contrary to government's wishes and expectation, the demand for foreign exchange continued to be on the increase resulting into further depreciation of the Naira. The Naira was actually allowed to be floated from 5th March 1992 to enable it find its level. This was quickly followed by what we call "guided deregulation". By this policy, the autonomous foreign exchange market continued to exist side by side with the official exchange rate put at twenty-two Naira to one U.S. Dollar. It was agreed that Commercial transaction should attract the Autonomous Foreign Exchange market of between 82 Naira to 85 Naira while the official government transaction should be based on 22 Naira to one U.S. Dollar. With this dual policy, according to the government, it is hoped that the two will be merged into one reasonable and accepted rate to the monetary authorities.

The dual exchange rate now in operation has been criticised by many economists on the ground that it is distortionary. Besides, it has been argued that there may be possible abuses in the implementation of this policy as government is the sole determinant about what to use the official rate for.

From the foregoing analysis, the financial markets in Nigeria especially, that of the foreign exchange market, is in the process of development. The painful issue is that the development in the financial markets with Naira depreciating, is the cause of the major negative changes in the economy as a whole. For one, the depreciation had made the importation of industrial raw materials difficult if not impossible leading to undercapacity utilisation. The resultant undercapacity utilisation had led to reduction in

the level of output/GDP, thereby retarding growth in the economy as a whole. Therefore, exchange rate devaluation which was the aftermath of SAP conceived by President Babangida in 1986 for a maximum of two years, continues up till today even though other aspects of SAP policies have been abrogated. As at now (1997), this policy of enabling the Naira to find its level since ten years back, has no definite acceptable level for Naira against foreign currencies. This aspect of monetary policy is therefore not effective.

5.2 NAIRA EXCHANGE RATE AND INFLATION IN NIGERIA.

Factors that put pressure on prices directly influence the exchange rate. These factors may be analysed in two ways - inadequate supply of and high level of demand for goods and services. Supply shortages can be tackled through increased import of essential goods and encouraging domestic production. The increased demand depends on the amount or level of liquidity in the economy. In fact the increase in money supply arising from the increase in the petroleum pump price had increased the liquidity situation of the Nigerian economy in recent times. To stabilise prices therefore require increasing supply to satisfy a given level of demand or reducing demand to match available supply. However, increasing supply with the existing exchange rate could not be possible due to shortage of foreign exchange leading to high cost of foreign currencies that could be used for both imports and domestic production. The Nigerian industries that produce the much needed goods have to slow down production due to their inability to obtain the necessary amount of foreign exchange for the importation of raw materials.

It is a well known fact that the Nigerian economy depends on imported inputs for basic production.

Liquidity mop-up as a tool of monetary policy to suppress demand has its impact on the Nigerian economy. It was argued that the growth of money supply without a growing productive output is inflationary. The mop-up of liquidity does not have a long-run effect on prices in the Nigerian economy and in the economy of most developing nations. This is because, it could have short-term effect on demand only at the particular period. The aftermath of the mop-up in Nigeria was always characterised by speculations which was always not in favour of the economy. In a situation where the speculators expect the price of foreign exchange to rise, they buy and keep the goods until the prices rise and re-sell for gain. Speculators also pick holes in the management of the economy by the monetary authorities' inability to respond quickly to the devastating economic situation. This enables the speculators to predict accurately about the movements of foreign exchange prices and the expected inflationary trend emanating from foreign exchange volatility resulting in higher inflationary trend. As long as there are shortages of foreign exchange, the predictors could be able to guess right and react promptly to enable them gain. The gain of the speculators is a loss to the economy in general through higher prices that may be impossible for the monetary authorities to control.

5.3 DOMICILIARY ACCOUNTS AND FOREIGN EXCHANGE MANAGEMENT IN NIGERIA

Prior to SAP, the national currency was generally adjudged to be over valued and this contributed to substantial foreign exchange obligations to foreigners. The shortage

of foreign exchange and the difficulties in meeting outstanding obligations, led to the intensification of exchange control measures with all the attendant problems. As one of the principal aims of SAP was the need to achieve a realistic exchange rate in order to remove distortions and rigidities in the economy, the government conceived the idea of Domiciliary accounts. The Domiciliary accounts therefore were officially recognised private foreign currency accounts into which foreign currency proceeds were lodged. This was meant to enable Nigerians to repatriate their foreign currencies kept abroad. By so doing, this could increase the much needed foreign exchange in Nigeria. These accounts were established by Decree No. 18 of 1985 consisting of ordinary Domiciliary account and non-oil export Domiciliary account. The accounts may be in the following major currencies, namely, the U.S. Dollar, the British Pound Sterling, the French Franc, the Deutsche Mark, the Swiss franc and Sub other foreign currencies that were being approved by the Nigerian government. The government made it clear that it shall not verify the owners and by which means such owner(s) obtained such money so as to enable all monies owned by Nigerians in foreign currency to be repatriated without fear. Interest rate payable in respect of the accounts were as determined by the CBN from time to time. Below is the inflow of the U.S. Dollar equivalent of the domiciliary account.

Inflow into Domiciliary Accounts ($ Million) 1986-1991.

Year	U.S. Dollar	Difference	% Change
1986	37.2	-	-
1987	254.7	217.5	584.7
1988	462.4	207.7	81.5
1989	654.4	192.0	41.5
1990	664.0	9.6	1.5
1991	774.2	110.2	16.6

Source: CBN Bulletin of 1995.

From this given table, the inflox of foreign currency which started in 1986 with 37.2 million Dollars, has been on the increase. It amounted to about 774 million Dollars in 1991. However, the demand for foreign exchange had still been on the increase. The domiciliary account operation has failed to meet the much needed foreign exchange demand in Nigeria. There were many problems associated with the operation of domiciliary account in Nigeria. Some of these could be discussed further.

There was the problem of unauthorised dealers who wanted the account holders to withdraw their foreign accounts and make more gains from the black-market by buying and selling of foreign exchange. These unauthorised dealers were always interested in the fall of the value of Naira in favour of the foreign currency to enable the foreign account owners make more Naira instead of waiting for the CBN to determine the rate of interest which was not comparable to the black market selling rate. In this case, the bank therefore becomes a conduit pipes through which profitable business were made in the parallel market.

The other problem area of this domiciliary account was the lack of efficient clearing system. In some cases, it took month to clear a cheque before payment could

be made because of the correspondence problem involved between the local branches and their overseas correspondents. Moreover, the higher number of Naira representing the few number of foreign currencies made it easy for any account holder to change from foreign currency to local currency. This made it difficult for the inflox of the foreign currency to serve its purpose.

5.4 MONETARY POLICY EFFECTS OF BALANCE OF PAYMENTS ON NIGERIA

The maintenance of a healthy and sustainable Balance of Payments position has become one of the major pre-occupations of policy makers worldwide (Enuenwosu, 1982). The Balance of Payments (BOPs) is a systematic statistical record of the economic transactions between the residents of one country and those of the rest of the world during a given period of time usually a year. The BOPs is said to be favorable or in surplus when there is excess receipts from other countries over payments made to others. We talk of BOPs deficit in terms of more payments made than receipts from other countries in international trade. By this, every country is always advocating for a BOPs surplus rather than deficit. The BOPs is usually divided into current and capital accounts for analytical purposes. The BOPs on current account is the record of all transactions between one country and the rest of the world for all visible and invisible goods and services. Some of the current account items that constitute the major components are import, export, services and investment income. The capital account records movements of long-term and short-term capital. Some of these are direct investment as well as short-term and long-term capital.

The study of the Nigerian BOPs between 1981 and 1994 showed that the current

account was favorable or was in surplus in 1984, 1985, 1989 and 1990 only. The favorable years for the capital account was between 1981 to 1984 and thereafter 1994. Except in the year 1984 and 1985, the Nigerian government did not have a favorable BOPs between 1981 and 1990 on the overall balance (see Appendix X). However, between 1987 and 1994, the government tried to correct the unfavourable situation through financing. Such financing was in exceptional financing, the promissory notes (arreas) and other miscellaneous ways to narrow the gap of the unfavourable situation.

In general, the management of BOPs is usually couched in terms of expenditure changing and expenditure switching policies. Expenditure changing policy refer to fiscal policy in which the policy makers manipulate government expenditure and taxation in general and the use of monetary policy through the change in money supply to effect the rate of interest. Expenditure-switching refers to the devaluation and revaluation of domestic currency all with the aim of switching domestic demand from importing to domestic goods. There is also the need to increase output in order to correct BOPs position. However, output may not be able to improve as long as we depend on imported inputs. Also, the higher cost of imported inputs are impediments to production resulting in the present undercapacity utilization.

From the foregoing analysis, both the fiscal and monetary policy had been in use for attaining a favorable BOPs in Nigeria. However, the monetary policy has not been effective in solving the BOPs problem because the money supply has always been on the increase. Moreover, the interest rate policy of controlling the volume of money supply, has not been effective because of the existence of the unorganised financial sector.

5.5 EXCHANGE RATE MOVEMENT AND THE GROSS DOMESTIC PRODUCT (GDP)

The management of Exchange rate in Nigeria is expected to enable a realistic exchange rate through the forces of demand and supply. By so doing, and according to the policy makers, there could be a greater utilisation of industrial capacity as well as the expansion of domestic production which may lead to a reduction in the level of unemployment and subsequently increased growth in the Nigerian economy. The growth in the Nigerian GDP (see appendix XI) at an annual average rate of between 1.5 to 2.5, has not been encouraging. Moreover the normal growth rate of the GDP if compared with the exchange rate movement. has not been encouraging. Also in comparism with population growth rate in Nigeria which has been said to be between 3 to 4 per cent, this would result to a draw-back in the per capita income. The Nigeria's per capita income is always quoted in dollar while the exchange rate have been depreciating against the Naira value. This therefore is not an expected development. This noticeable decline in the standard of living in Nigeria shows that this policy (monetary) has not been effective.

Moreover, the undercapacity utilisation in the industrial sector today which emanated from the high cost of imported inputs, has resulted into the slow rate of output expansion and subsequently low rate of growth. Therefore, the current exchange rate managements has made it impossible for the importers of industrial inputs to bring in the necessary raw material for production that could lead to growth in the GDP and hence the economy as a whole. Moreover the policy has brought about imported inflation as a result of higher cost of industrial inputs resulting in higher cost per unit of output and subsequently higher domestic prices.

CHAPTER SIX.

6.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

6.1 SUMMARY

This thesis has attempted to find out the effectiveness of monetary policy in Nigeria. The interest of the thesis is that the financial markets which the monetary policy in Nigeria could work through is developing.

In chapter one, of course, the introductory chapter, we looked into the development of the Nigerian monetary policy first begining with the introduction of the West African Currency Board. This was later followed by the introduction of the CBN which was the sole institution that formulated and executed the government monetary policy. The institution of the CBN in 1959 therefore marked the beginning of an indigenous formulation of monetary policy. This chapter also reviewed the development in the Nigerian economy from the pre-colonial date to-date. We defined monetary policy and what it was made to do for a country and for Nigeria in particular.

The issue of the indigenisation of the credit base after the introduction of the money and capital markets was also part of the introduction. The previous government policies that were related to monetary policy were briefly mentioned. The operational tools of monetary policy were reviewed only without trying to analyze how they were put into use in Nigeria.

The chapter was concluded with the research statement of problems, objectives, justification, methodology and its scheme of chapter.

In chapter two, various monetary policy related literatures were reviewed. Before

going into the monetary theory, efforts were made to look into the policy issues of some successful developed countries like Belgium, France, United Kingdom, Italy, Netherlands to mention just a few.

This chapter reviewed various theories of monetary management which included the loanable theory of interest rate, the liquidity preference theory of interest rate and their likes. The related expectation argument as it related to interest rate and the tight bank lending policy was observed.

The monetarist-Keynesian debate formed part of the review. While the monetarists were of the opinion that there is a direct and reliable link between the money supply and the GNP. The Keynesians were of the opinion that velocity may not be stable in both the short and the long-run. In the Keynesian world, it was viewed that increases in demand for financial assets with a resultant rise in prices of security when the interest rate falls, the GNP may not be directly affected. Therefore the Keynesian analysis did object to the use of monetary policy especially in tackling a country's inflationary processes.

The quantity theory of money was also reviewed especially as it related to a change in the money supply and its resultant effect on the GNP. That a change in money supply leaves the GNP unchanged but increase the Naira value of GNP (nominal GNP). However, we observed that the Keynesian were less concerned with the real versus nominal distinction of the GNP.

The relationship between the financial markets and the economic activities were reviewed. It was observed that the financial markets were the transmission mechanism

between savers-lenders and borrower-spenders. The first sector to experience the impact of monetary policy is of course, the financial markets. This chapter was concluded with, the analysis of the development of monetary policy in Nigeria since the inception of characterised by the CBN. The monetary policy issue in Nigeria had been easy-follow-tight policy since 1960. Also, both the keynesian and monetarists policy prescriptions had been in use in Nigeria.

The third chapter treated the monetary policy implementation in Nigeria starting with the phases of monetary policy in Nigeria. The money supply was later examined where we noted that it had been on the increase in nominal value. Nominal because the rate of exchange started depreciating since the introduction of SAP in 1986. The interest rate movement during the period of SAP was such that it was allowed to find its level through the forces of demand and supply. The deregulation of interest rate with its resultant increases did not stop people from borrowing. In appendix III therefore, with the increase in bank rates borrowers continued to borrow. Fluctuations in the rate of interest therefore did not stop people from borrowing or that interest rate policy is not an effective means of controlling liquidity in the economy.

The sectorial distribution of bank loan was an area where the monetary authorities are finding it difficult for the effectiveness of monetary policy. Banks tend to violate the government policy for their profit motives.

The management of interest rate has become a controversial issue among the monetary authorities in Nigeria. Some are of the opinion that it should be regulated. Others are saying that it should be deregulated while the present government policy of

guided deregulation is not supported by some members in the CBN.

Monetary policy issues regarding the management of inflation in Nigeria has failed. Inflationary trend in Nigeria since the introduction of SAP had given rise to so many questions about the policy to control inflation. Both monetary and fiscal policy tools had not been effective except that government expenditure tool which has its effect on demand and the resultant unemployment effects.

Reserve requirement as a tool of monetary policy has no much effect for the simple reason that not all money in the economy go through the banking sector of the economy. The unorganised financial markets have the lion share of the available money in the economy. For this same reason indirect monetary policy instrument particularly OMO, has not been effective due to ineffective banking habit among the people. In general, some instruments of monetary policy have their short-term effective but not in the long-run.

In chapter four, we did the performance appraisal of the financial markets in Nigeria. The financial markets which comprise of the money and capital markets with its supply-leading policy since the inception of the CBN, had failed to inculcate the banking habit on the members of the public in Nigeria. As a result, the members of the public do not much participate in treasury bills, treasury certificates and other related money market instruments available that could mop-up liquidity from the economy. Moreover, the inflationary trend and expected inflation do not encourage the Nigerian people to invest in long-term securities. If they did, the expected yields would are always not be comparable with the speculative yields of those holding short-term assets.

The government's participation in the long-term securities is noticeable but the government alone could not control the money supply without the rest members of the public.

The supply leading development in the banking sector which was also extended to development banking institution is a welcome development in the financial sector. However, some of these banks failed to serve the purpose for which they were instituted. Government therefore continue to finance and re-finance such banks only to note that corruption is characterised of their operations. The peoples' bank are characterised by operation problem resulting from corruption.

The problems in the formal financial sector have given rise to the non-effectiveness of monetary policy. The informal Lending institution had a lot of impact in the Nigerian economy resulting in the authorities' inability to control or mop-up liquidity. With the existence of IFS, the CBN cannot control the loans and hence the liquidity situation.

The fifth chapter studied the situation with the exchange rate management especially since the introduction of SAP. The movement of exchange rate since then has not been in favour of Naira. Our currency had depreciated to the extend that the policy makers are not sure of what the so called realistic exchange rate of Naira is. The study showed that the current inflationary trend could be linked to the exchange rate depreciation since we are primary producers in Nigeria. The introduction of domiciliary account to enable more inflow of foreign exchange into the country, had no much impact on the supply of foreign exchange into this country.

The overall BOPs in Nigeria with the oil revenue has not been encouraging. The Monetary policy especially the current exchange rate policy was detrimental to the BOPs situation in Nigeria. Therefore the expenditure changing policy of the government towards obtaining a favorable BOPs has not been effective due to exchange rate depreciation.

The growth in the Nigerian economy has not been encouraging as noticed from the GDP data. The study saw the impediment to growth as the inability of the Nigerian industries to bring in the necessary raw materials due to the higher cost of inputs which emanated from the low value of Naira compared to the exporting countries currencies.

6.2 CONCLUSION AND POLICY RECOMMENDATIONS.

The development of the financial sector into a modern Nigerian financial system which could serve effectively the economic functions of the transmission of funds and the allocation of credit is clearly a long-term goal. The supply-leading financial development in the Nigerian financial system especially in the financial markets had failed to serve its purpose of inculcating the banking habit in the Nigerian people. For this reason, many richer people especially the uneducated ones were operating outside the banking system. This among others, had made many monetary tools ineffective.

The CBN cannot mop-up excess liquidity in the economy because of the existence of the informal financial sector. Their inability to control excess liquidity effectively had resulted in the continued inflationary trend. The inflationary trend had made interest rate policy ineffective because of the devaluation effect of the long-term interest bearing

assets. The resultant public participation in the money and capital market has been low. There is a diversion from the FFS to the IFS thereby giving rise to little or no control of the money supply by the monetary authority.

The most important problem that handicapped the monetary authorities in the monetary management, was the issue of exchange rate devaluation. As earlier stated, the devaluation had given rise to undercapacity utilisation and slow rate of growth. It did not also serve its purpose of correcting the unfavourable BOPs for many years. Nigeria is today moving from one policy prescription to another in her monetary management. The inability of the authorities to settle on one or a set of policy, is an indication that we are not achieving our expected goals and aspiration. In this case, our financial markets which is developing is still searching for effective tools for effective monetary policy.

In view of the foregoing analysis, the following are the policy prescriptions. The federal government of Nigeria should intensify efforts in trying to sanitise the banking sector. By so doing, more public confidence of the banking sector could lead to a sizeable amount of money in circulation going through the banking sector. This could reduce the activities of the IFS. The reduction in the activities of the IFS could enable the various tools of monetary policy to be effective.

Monetary policy lags is another area the authorities should look into. It takes the monetary authorities so much time to realise that movements in some macroeconomic variables are detrimental to the economy. When the members of the public are crying that the rate of price increase in Nigeria is high, for example, most policy makers in government are always in disagreement with the rate of inflation until it reaches the point

that they may find it difficult to control. The monetary authorities in Nigeria should therefore tackle any monetary problem as quickly as they could before its devastating effects on the economy.

The use of indirect monetary tools should be minimised as the economy is developing because without a developed economy, the effectiveness of indirect monetary tools will always be doubtful. Every Nigerian should be banking conscious for the indirect monetary tools to be effective.

The level of corruption in Nigeria today is high. As long as Nigeria cannot be able to tackle corruption among the top government functionaries, the resultant leakages that pump purchasing power into the hands of many Nigerians could render a non-inflationary policy ineffective.

For effective monetary management in Nigeria the money and capital markets should develop beyond its current development. In this area, the introduction of people's bank and community bank is a welcomed development if only the federal government via the monetary authorities would supervise its operation well to reduce the case of distress. The present government policy of increasing the capital base of the Commercial banks could result in the more problem of underbanking in the economy. Less banks therefore increase the activities of the IFS which is detrimental to the effectiveness of monetary policy.

The members of the public should be educated and informed about the issue of Stocks and Shares and the need to save in banks. This should enable the liquidity mop-up tool to be effective whenever the authorities apply the tool.

The Federal Government of Nigeria should, through the monetary authority, determine a fixed and realistic exchange rate system that is lower than the existing one. By so doing, the dominant imported inflation which is as a result of higher cost of imported inputs, could be tackled. Low inflation rate is the only main means of inculcating the banking habit into the people leading to the reduction in the activities of IFS and subsequently the effective use of indirect monetary tools for the effectiveness of monetary management.

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Appendix I - Money Supply in Nigeria (₦million)

Year/Qrt	Currency Outside Bank[1]	Demand Deposits	Money Supply(M1)[2]	Demand Depposits as % of Money Supply (M1)	Quasi Money[3]	Money Supply (M2)[4]
1970	342.3	266.0	608.3	43.7	341.6	949.9
1971	354.5	274.4	628.9	43.6	376.4	1,005.3
1972	385.2	314.9	700.1	45.0	461.2	1,161.3
1973	435.9	391.2	827.1	47.3	586.9	1,414.0
1974	569.8	608.5	1,178.3	51.6	977.9	2,156.2
1975	1,030.7	1,013.3	2,044.0	49.6	1,578.4	3,622.4
1976	1,540.0	1,941.8	3,293.0	59.0	1,985.9	5,278.9
1977	1,940.0	2,853.6	4,794.4	59.5	2,263.1	7,057.5
1978	2,157.2	2,932.5	5,089.7	57.6	2,609.8	7,699.5
1979	2,350.8	3,795.8	6,146.8	61.8	3,710.6	9,857.4
1980	3,185.9	6,040.9	9,226.8	65.5	5,170.6	14,397.4
1981	3,861.9	5,883.0	9,744.9	60.4	5,803.2	15,548.1
1982	4,222.4	5,826.2	10,048.6	58.0	6,845.4	16,894.0
1983	4,842.8	6,639.6	11,282.4	57.1	8.086.5	19,368.9
1984	4,883.5	7,320.6	12,204.1	60.0	9,396.4	21,600.5
1985	4,909.9	8,357.9	13,267.8	63.0	10,550.8	23,818.6
1986	5,177.9	7,927.1	13,105.0	60.5	11,487.7	24,592.7
1987	6,298.6	8,607.3	14,905.9	57.7	15,008.7	29,994.6
1988	9,412.3	11,736.3	21,148.6	55.5	21,631.7	42,780.3
1989	11,688.4	14,009.2	25,697.6	54.5	20,525.3	46,222.9
1990	14,940.6	22,293.1	37,233.7	59.9	27,699.0	64,902.7
1991	23,108.2	26,256.3	49,364.5	53.2	36,788.0	86,152.5
1992	36,765.9	38,406.6	75,172.5	60.0	53,111.2	128,283.7
1993	56,254.5	60,338.9	116,593.4	51.7	79,724.8	196,318.2
1994	90,492.0	81,512.7	172,004.7	47.4	95,755.1	267,759.8

1 Currency outside banks is defined as currency in circulation less vault cash in Commercial banks and Merchant Banks

2 Money Supply (M1) is defined as currency outside banks plus privately held demand deposits with the commercial banks and the Central Bank.

3 Quasi-Money (QM) is defined as Savings and Time deposits with Commercial banks plus total deposit liabilities of Merchant banks. prior to 1988, quasi money did not include the deposit liabilities of Merchant banks.

4 Money Supply (M2) is composed of M1 and Quasi Money as define above.

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX II COMMERCIAL BANKS SELECTED PREDOMINAT INTEREST RATES (PER CENT)

Commercial Banks								
Deposit Rates					Lending Rates			
Time				Savings				
3 Months	3-6 Months	6-12 Months	Over 12 Months		First Class Advance	Produce Advance	Other Advances	Federal Savings Bank[1]
3.00	3.00	4.50	4.00	3.00	7.00	7.75	8.00	2.50
3.00	3.00	3.50	4.00	3.00	7.00	9.00	10.00	2.50
3.00	3.50	4.00	4.00	3.00	7.00	10.00	10.00	4.00
3.00	3.50	3.50	4.00	3.00	7.00	10.00	10.00	4.00
3.00	3.50	4.00	4.00	3.00	7.00	10.00	10.00	4.00
3.00	3.50	3.50	4.00	4.00	6.00	9.00	9.00	5.00
3.00	3.50	3.50	3.50	4.00	6.00	8.00	10.00	5.00
3.50	3.00	300	3.50	4.00	6.00	6.00	6.00	5.00
4.75	2.50	5.25	5.50	5.00	7.00	11.00	11.00	5.00
4.75	5.00	5.50	5.50	5.00	7.50	9.00	11.00	5.00
5.75	6.00	6.25	6.50	6.00	7.50	8.50	9.50	6.00
5.50	6.00	6.25	6.50	6.00	7.75	9.75	10.00	6.00
7.25	7.50	7.75	8.00	7.50	10.25	7.75	11.75	7.50
7.25	7.50	7.75	8.00	7.50	10.00	9.75	11.50	7.50
9.75	9.50	9.75	10.00	9.50	12.50	7.00	13.00	9.50
9.25	9.50	9.75	10.00	9.50	9.25	8.50	11.75	9.50
9.25	9.50	9.75	10.00	9.50	10.50	10.50	12.00	9.50
14.90	15.30	15.10	15.80	14.00	17.50	19.00	19.20	14.00
13.40	12.10	13.70	14.30	14.00	16.50	17.30	17.60	14.50
18.90	21.60	21.40	21.20	16.40	26.80	25.90	24.60	16.40
19.60	20.50	22.10	23.00	18.80	25.50	26.00	27.70	18.80
15.71	17.09	20.10	20.10	14.29	20.01	20.51	20.80	14.29
20.80	22.30	22.10	20.50	16.10	29.80	30.80	31.20	16.10
15.00	15.00	15.00	15.00	13.5	21.00	n.a	21.00	-
23.90	25.60	24.40	23.00	17.20	28.10	28.80	29.60	-
26.80	27.67	27.61	28.29	18.93	37.22	35.47	36.69	-
26.97	27.84	28.83	29.02	19.17	39.77	45.30	32.25	-
23.60	23.26	23.99	28.02	16.66	36.09	39.06	18.32	-
19.75	21.00	22.00	23.00	15.00	25.00	28.00	15.00	-
15.00	15.00	15.00	15.00	13.51	21.00	21.00	20.00	-

[1] The Federal Savings Bank started operating as a commercial bank in 1988. they adopted the common savings rate.

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994
The above data is from 1970 to 1994.

APPENDIX III BANKING SYSTEM'S CREDIT TO THE ECONOMY (₦)

Year/ Quarter	Aggregate Credit (Net)[1]	Credit to Private Sector	Credit to Government Sector (Net)[2]	Credit by Central Bank	Credit by Commercial Bank
1980	10,780.1	7,190.9	3,589.2	1,713.2	9,006.9
1981	16,261.4	9,654.4	6,607.2	5,491.3	10,770.1
1982	21,178.4	11,371.5	10,528.2	8,475.0	13,424.7
1983	28,178.4	12,353.9	15,824.5	11,591.0	16,587.4
1984	31,136.5	12,942.0	18,194.5	10,711.5	20,425.0
1985	32,680.3	13,700.2	18,980.1	10.265.3	22,415.0
1986	36,820.3	17,365.0	19,455.3	16,510.8	20,309.5
1987	46,926.4	25,476.1	21,450.3	16,210.8	25,871.2
1988	57,326.3	29,773.6	27,552.7	22,776.0	29,284.5
1989	49,259.1	30,942.8	18,316.3	19,795.1	32,525.1
1990	57,674.9	36,631.0	21,043.9	24,393.5	33.401.1
1991	83,823.7	45,325.2	38,498.5	34,414.0	37,646.9
1992	141,735.7	61,020.3	80,715.4	82,482.3	44,906.9
1993	271,350.9	92,501.6	178,849.3	145,599.4	94,841.4
1994	350,622.7	122,273.3	228,349.4	187,790.4	132,647.2

1 Gross credit to the domestic economy, less Federal Government's deposit with the banking system

2 Gross credit to the Federal Government, less Federal Government's deposit with the banking system.

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX IV: MATURITY STRUCTURE OF COMMERCIAL BANKS' LOANS AND ADVANCES.

(₦ million)

Maturing								
Year/Qt	On Call (1)	Within 6 Months (2)	Between 6-12 Months (3)	Within 12 Months[1] (4)	Between 1-3 Years (5)	Between 3-5 Years (6)	After 5 Years (7)	Total (8)
1980	3,246.0	822.7	727.0	197.7	663.2	408.1	306.1	6,377.3
1981	4,369.5	911.7	1,066.6	352.7	731.1	645.1	516.1	8,601.4
1982	5,157.1	1,540.9	996.5	390.4	852.7	749.9	585.6	10,273.1
1983	5,126.4	2,052.8	1,020.8	832.2	898.8	943.2	221.9	11,096.1
1984	5,448.3	1,885.0	1,091.9	678.2	954.0	781.6	632.2	11,494.2
1985	6,142.1	2,189.3	1,204.1	437.9	960.8	608.1	608.1	12,162.5
1986	8,026.9	2,976.9	1,574.2	732.5	1,153.4	1,013.1	763.7	15,586.2
1987	8,677.9	2,506.9	2,068.7	929.2	1,490.2	1,034.3	841.5	17,531.3
1988	10,421.3	3,229.9	2,376.8	853.2	1,564.2	1,076.7	792.3	20,314.4
1989	10,710.8	2,979.9	2,354.7	750.2	16,562.9	1,604.5	833.5	20,838.2
1990	12,370.9	4,772.0	3,060.3	259.4	1,841.9	1,322.7	1,322.7	25,935.0
1991	15,989.5	6,130.4	3,634.0	410.8	2,401.6	1,674.8	1,548.4	31,599.9
1992	22,739.0	7,670.9	3,975.6	336.6	2,839.3	1,993.0	2,453.8	42,008.2
1993	28,799.0	11,817.8	5,635.1	1,276.3	3,500.0	3,117.5	3,048.2	55,917.6
1994	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A

[1] Consist of commercial papers, bankers acceptance, bills discounted and money at call outside banks.

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX V

INFLATION RATE

Year	% increase in Money Supply	Inflation Rate
1970[1]/	42.5	13.8
1971	3.4	15.6
1972	11.3	3.2
1973	18.1	5.4
1974	42.5	13.4
1975[2]/	73.5	33.9
1976	61.1	21.2
1977	45.6	15.4
1978	6.2	16.6
1979	20.8	11.8
1980	50.1	9.9
1981	5.6	20.9
1982	3.1	7.7
1983	12.3	23.2
1984	8.2	39.6
1985	8.7	5.5
1986	-1.2	5.4
1987	13.6	10.2
1988	43.9	38.3
1989	19.8	40.9
1990[3]/	44.9	7.5
1991	32.6	13.0
1992	46.2	44.5
1993	55.1	57.2
1993	N.A	54.2
1994	N.A	57.0
1995	N.A	72.8

1/ From 1970 - 1974 calculated with 1960 as Base Year

2/ From 1975 - 1989 calculated with 1975 as Base Year

3/ Calculated with 1985 as the Base Year.

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX VI: HOLDINGS OF TREASURY BILLS AND TREASURY CERTIFICATES OUTSTANDING (PER CENT)

Year	Central Bank	Call Money Fund	Commercial Banks	Merchant Banks	Governments	Others
1960	15.2	-	20.5	-	-	64.3
1961	39.2	-	17.5	-	-	43.3
1962	19.5	14.2	14.0	-	-	52.3
1963	52.3	11.6	3.9	-	5.4	26.8
1964	19.4	14.3	15.8	-	19.1	31.4
1965	31.2	8.1	16.1	-	12.6	32.0
1966	45.3	5.3	17.5	-	10.2	21.7
1967	56.4	3.5	17.0	-	9.5	13.6
1968	3.3	3.4	75.3	0.2	3.2	14.6
1969	4.9	2.5	69.4	0.5	2.4	20.3
1970	12.8	3.6	63.2	0.5	4.7	15.2
1971	17.2	2.8	33.3	0.3	33.6	12.8
1972	4.1	3.8	41.7	0.5	38.0	11.9
1973	11.7	4.5	42.4	0.8	27.1	13.5
1974	2.2	-	83.7	0.4	3.7	10.0
1975	0.5	-	87.5	0.2	3.1	8.7
1976	0.7	-	83.2	1.1	1.2	13.8
1977	15.1	-	69.4	2.0	1.5	12.0
1978	47.9	-	37.8	0.6	1.4	12.3
1979	24.8	-	49.5	1.4	1.8	22.5
1980	32.8	-	50.2	1.2	0.8	15.0
1981	55.8	-	21.9	0.9	0.2	21.2
1982	56.4	-	25.0	1.5	0.0	17.1
1983	52.1	-	28.0	2.1	0.1	17.7
1984	41.9	-	39.9	4.1	0.0	14.1
1985	41.9	-	43.4	4.8	0.1	9.8
1986	53.8	-	18.7	0.3	0.0	27.2
1987	55.3	-	23.8	0.9	0.0	20.0
1988	62.1	-	17.3	0.4	0.0	20.2
1989	50.4	-	11.7	0.3	0.0	37.6
1990	58.1	-	14.6	0.6	0.1	26.6
1991	74.3	-	7.4	0.7	0.1	17.5
1992	83.1	-	4.0	0.7	0.1	12.1
1993	57.0	-	21.1	6.8	0.0	15.1

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX VII: MONEY MARKET ASSETS OUTSTANDING

APPENDIX VII: MONEY MARKET ASSETS OUTSTANDING

N'MILLION					
Year	Treasury Bills (1)	Treasury Certificates (2)	Commercial Papers (3)	CD, BUF and EDS[1/] (4)	Total Outstanding (5)
1960	18.0	-	2.3	-	20.3
1961	34.0	-	2.2	-	36.2
1962	48.0	-	6.2	-	54.2
1963	60.0	-	14.8	-	74.8
1964	68.0	-	30.1	-	98.1
1965	80.0	-	42.0	-	122.0
1966	128.0	-	60.1	-	188.1
1967	168.0	-	36.4	-	204.4
1968	240.0	20.0	5.1	-	265.1
1969	340.0	142.0	4.5	-	486.5
1970	556.0	236.0	6.0	-	798.0
1971	616.0	250.0	11.2	-	883.2
1972	616.0	286.0	9.3	-	911.3
1973	614.0	286.0	7.9	-	909.9
1974	616.0	286.0	15.4	-	917.4
1975	616.0	286.0	32.4	49.8	984.2
1976	616.0	652.0	27.0	175.4	1,470.4
1977	619.0	900.0	26.3	437.3	2,054.6
1978	816.0	1,700.0	45.6	248.2	2,809.8
1979	2,119.0	2,210.0	24.3	247.1	4,600.4
1980	2,119.0	2,727.6	48.1	180.9	5,075.6
1981	5,619.0	2,307.6	73.0	286.8	8,286.4
1982	9,619.0	1,668.6	110.4	461.0	11,859.0
1983	13,476.0	4,894.4	153.3	527.4	19,051.1
1984	15,476.0	6,413.1	156.7	366.6	22,412.4
1985	16,976.0	6,654.1	139.0	258.2	24,017.3
1986	16,976.0	6,654.7	259.0	477.3	24,367.0
1987	25,226.0	6,654.1	496.4	1,365.2	33,751.7
1988	35,476.0	6,794.6	668.9	1,905.6	44,845.1
1989	24,126.0	6,944.6	737.2	1,321.4	33,129.2
1990	25,476.0	34,214.6	913.5	1,905.9	62,510.0
1991	56,728.3	34,214.6	1,031.6	1,107.4	93,081.9
1992	103,326.5	35,241.4	1,701.9	536.5	139,770.5
1993	103,326.5	36,584.3	5,091.0	100.8	145,102.6

1. CD = Certificate of Deposit; BUF = Bankers' Unit Fund; EDS = Eligible Development Stocks

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX VIII: TRANSACTIONS ON THE NIGERIAN STOCK EXCHANGE

Number				Value N'Million		
Year	Government	Industrials	Total	Government	Industrials	Total
1961	92	242	334	1.4	0.1	1.5
1965	391	629	1,018	15.2	0.6	15.8
1966	501	595	1,096	15.2	1.2	16.4
1967	336	427	763	12.1	0.3	12.4
1968	286	360	646	12.3	0.2	12.5
1969	307	246	553	16.2	0.2	16.4
1970	303	331	634	16.4	0.2	16.6
1971	204	748	952	32.6	3.5	36.1
1972	258	640	898	52.3	2.0	54.3
1973	282	537	819	91.9	0.5	92.4
1974	256	2,807	3,063	48.4	1.3	49.7
1975	193	501	694	63.7	0.6	64.3
1976	321	696	1,017	111.3	0.6	111.9
1977	337	1,314	1,651	178.8	1.2	180.0
1978	252	2,234	2,486	187.3	2.4	189.7
1979	124	3,099	3,223	249.7	4.7	254.4
1980	220	6,918	7,138	380.9	7.9	388.8
1981	110	10,081	10,199	298.7	6.1	304.8
1982	184	9,830	10,014	207.0	6.0	215.0
1983	292	11,633	11,925	384.7	13.0	397.7
1984	194	17,250	17,444	241.0	15.7	256.7
1985	314	23,232	23,546	295.3	23.2	318.5
1986	270	27,448	27,718	475.6	20.0	495.6
1987	238	20,410	20,648	338.2	42.3	380.5
1988	96	21,466	21,562	217.1	32.4	249.5
1989	171	33,273	33,444	490.5	62.7	553.2
1990	111	38,881	38,992	153.9	112.9	272.8
1991	45	41,725	41,770	92.7	149.4	242.1
1992	71	48,958	49,029	85.0	406.7	491.7
1993	39	40,359	40,029	84.7	719.7	804.4
1994	13	44,091	44,104	14.1	1,070.5	1,08.6

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX IX; NAIRA EXCHANGE RATES

Year	Dolla ₦ US$	Pound Sterling ₦/#
1970	0.7142	1.7114
1971	0.6944	1.7156
1972	0.6579	1.6289
1973	0.6579	1.6289
1974	0.6293	1.4795
1975	0.6158	1.3618
1976	0.6266	1.1317
1977	0.6466	1.1617
1978	0.6351	1.2238
1979	0.6027	1.2628
1980	0.5469	1.2647
1981	0.6052	1.2495
1982	0.6731	1.1734
1983	0.7506	1.1216
1984	0.7672	1.0765
1985	0.8924	1.1999
1986	1.7323	2.5554
1987	3.9691	6,5929
1988	4.5367	8.0895
1989	7.2292	12.6500
1990	7.9006	13,0838
1991	9.9095	17.4955
1992	17.2984	27.8684
1993	21.8861	32.6294
1994	21.8861	34.8096

Source: CBN Statistical Bulletin, Vol. 5 No.2 December 1994

APPENDIX X: NIGERIA'S BOPs 1981 - 1994

Year	Current A/C	Capital A/C	Net errors and Omissions	Overall Balance
1981	-3,988.4	929.5	48.1	-3,020.8
1982	-4,879.5	3,470.9	10.3	-1,398.3
1983	-3,137.9	2,735.7	100.9	-301.3
1984	44.1	171.9	138.9	354.9
1985	2,215.4	-2,555.0	-94.3	349.1
1986	-2,999.1	-1900.9	-767.7	-5,667.7
1987	- 295.3	-16,743.3	-1,226.2	-18,264.8
1988	- 965.7	-18,447.3	-1,382.0	-20,795.0
1989	8,232.3	-30,221.9	-1,003.9	-22,993.5
1990	19,350.4	-23,864.5	-1,247.8	-5,761.9
1991	-12,577.6	-2,249.9	- 971.1	-15,798.6
1992	-5,085.2	-94,247.9	-2,086.0	-101,419.4
1993	-19,488.8	-19,740.9	-2,507.1	-41,736.8
1994	-48,581.0	7,644.1	-1,686.4	-42,623.3

Source: CBN statistical Bulletin Vol. 5 No. 2 1994.

APPENDIX XI: NIGERIA GDP AT 1984 CONSTANT FACTOR COST

YEAR	GDP
1981	70,395.9
1982	70,157.0
1983	66,389.5
1984	63,006.4
1985	68,916.3
1986	71,075.9
1987	70,741.4
1988	77,752.5
1989	83,495.2
1990	90,342.1
1991	94,614.1
1992	97,431.1
1993	99,649.2
1994	101,040.1

Source: CBN statistical Bulletin Vol. 5 No. 2 1994.

Appendix XII: Number of Commercial and Merchant Banks in Nigeria.

Year	Commercaial Banks	Merchant Bank
1970	14	1
1971	16	1
1972	16	1
1973	16	2
1974	17	3
1975	17	5
1976	18	5
1977	19	5
1978	19	5
1979	20	6
1980	20	6
1981	20	6
1982	22	8
1983	25	10
1984	27	11
1985	28	12
1986	29	12
1987	34	16
1988	42	24
1989	47	34
1990	58	49
1991	65	54
1992	66	54
1993	66	54
1994	66	51

Sources: C.B.N. Statistical Bullentin, Vol. 5, No. 2, December, 1994.