

FINANCIAL LIBERALIZATION AND SAVINGS MOBILISATION IN NIGERIA

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Financial liberalization involves the elimination of credit controls, deregulation of interest rates, easing of entry into the financial services industry, development of capital markets, increased prudential regulation and supervision, and liberalization of international capital flows. Reforms are expected to increase competitive efficiency within the financial market in at least three ways. Number one, the elimination of regulations and price distortions allow savings to be directed into highest-yielding (risk-adjusted) forms of investment (improved allocative efficiency). Number two, increased competition reduces the cost of financial intermediation (higher operational efficiency). Number three, the reform measures generate an improved range of financial products and services adaptable to changing consumer needs (dynamic efficiency). Although financial reforms can increase the efficiency by channeling resources into productive use, its impact on the quantity of savings is theoretically ambiguous.

From an analytical point of view, the

impact of financial reform on savings includes a direct, short-term, and an indirect, long term, effect. The direct effect works through the price and quantity channels. The price channel reflects the impact of reforms on savings through changes in the real interest rates. Fry (1978, 1995) reports that, across a sample of fourteen Asian countries, the gross national savings rate is positively affected higher real interest rates. However, the positive response is small and diminishes in later years. (Reynoso, 1989) finds that savings increase rapidly as real interest rates move from sharply negative to just below zero, but that the effect levels off at low positive real interest rates and becomes negative as interest rate rises. This raises the possibility of a nonlinear relationship between interest rates and savings, perhaps involving threshold effects.

The quantity channel affects savings by expanding the supply of credit to credit-constrained consumers. A number of studies have argued that the high level of savings evident in the East Asian countries and Japan can be attributed not to high interest rates but to bank expansion in rural areas and the availability of low-yielding but safe deposit instruments (Loayza et al., 2000). They estimated that a one percentage point increase in the ratio of private credit flows to income reduces the long-term private saving rate.. This seems to indicate that the expansion of credit reduces private savings as economic agents are able to finance increased consumption at

their current income level.

Financial liberalization, which leads to large capital flows, can also have short term implications for savings. Bandiera et al. (2000) have argued that the impact on savings of financial liberalization comes through the related changes in the availability and cost of credit, expected income growth, and increased wealth due to higher property values.

Stulz (1999) and Mishkin (2001) assert that financial liberalization promotes transparency and accountability, reducing adverse selection and moral hazard while alleviating liquidity problems in financial markets. These authors argue that international capital markets help to discipline policy makers, who might be tempted to exploit an otherwise confined domestic capital market. The prime benefits that the literature associates with liberalised financial system to the users of the financial services include; the reduction in the cost of services to both savers and borrowers with the introduction of more competition and improvements in services from more efficient, customer friendly financial institutions. Savers expect to receive higher rates of return, a broader choice of saving instruments and easier access to financial products. Borrowers benefit from more accurate appraisal of risk; reduced waiting period and expanded access to funds through more sophisticated lending instruments available in a wider range of maturities. The benefits of financial

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liberalization can therefore be grouped into increased access to domestic and international capital markets, and increased efficiency of capital allocation.

However critics of financial liberalization policies have contended that the efficient markets concept is fundamentally misleading when applied to capital flows. In the theory of the second best, removing one distortion need not be welfare enhancing when other distortions are present. If the capital account is liberalized while import competing industries are still protected, for example, or if there is a downwardly inflexible real wage, capital may flow into sectors in which the country has a comparative disadvantage, implying a reduction in welfare.

If information asymmetries are rife to financial markets and transactions, in particular in countries with poor corporate governance and low legal protections, there is no reason to think that financial liberalization, either domestic or international, will be welfare improving (Stiglitz, 2000). Furthermore, in countries where the capacity to honour contracts and to assemble information relevant to financial transactions is least developed, there can be no assumption that capital will flow into uses where its marginal product exceeds its opportunity cost. Stiglitz (1994) argues in favour of certain forms of financial repression. He claims that repression can have several positive effects such as: improving the average quality of the pool of loan applicants by lowering interest rates; increasing firm equity by lowering the price of capital; and accelerating the rate of growth if credit is targeted towards profitable sectors such as exporters or sectors with high technological spillovers. However, these claims can be doubtful given

that they increase the power of bureaucrats, who can be less capable than imperfect markets, to allocate financial resources. The key argument is that the government is, to all intents and purposes, the insurer of the financial systems, and hence a financial failure can have significant fiscal repercussions.

Overall, although financial reform promises immense benefits, it could also set in motion a process of change that imposes some costs, which if not covered carefully can result in a crisis. The path toward greater efficiency in financial services, like the path toward freer trade, implies the closure of those firms that remain unproductive and the gradual emergence of new practices. These new practices include modern supervision and regulation and the abandonment of the special relationships and poor lending practices that bear so much responsibility for the dismal state of financial sectors in most developing countries. Like trade in goods, competition will bring net benefits, but those who enjoyed protection will suffer and will try to oppose change.

Since the 1980s many emerging economies, including Nigeria embraced financial sector reforms and have had mixed results (Akyuz and Kotte, 1991). Starting in 1986, Nigeria's financial system began to be deregulated and by 1992 substantial changes had taken place. Consistent with trends in other developing countries, institutions and markets are growing and developing, leading to an increasing role being played by the financial system in the development of Nigeria's economy.

The main objective of this paper is to assess the impact of financial sector reforms on savings mobilization in Nigeria. Accordingly, the remaining part of the paper is organized as

follows; part two dwells on theoretical issues and brief review of literature. Part three contains a brief analysis of financial sector reforms in Nigeria, while part four assesses the impact of the reforms on savings. Summary, conclusion and recommendations are presented in part five.

2.0 Theoretical Issues and Review of Literature

One element of the Mackinnon-Shaw thesis is that abolition of ceilings on interest rates stimulates savings. Increased interest rates, however, may reduce rather than increase the volume of savings for a number of reasons. First, the negative income effect of increased interest rates might offset the positive substitution effect between consumption and savings. Second, an increase in the real interest rate may merely reallocate the existing volume of savings in favour of financial savings as opposed to other forms of savings and leave the total volume of savings unchanged (Gupta 1984, Rangarajan 1997). Such a reallocation may also occur if reforms provide a new range of financial instruments such as shares, mutual funds, postal savings and pension funds.

Third, at very low levels of income interest rates are unlikely to stimulate savings since the totality of incomes would be devoted to consumption. Statistical evidence on the issue suggests that a one percent increase in the real interest rate raises the saving rate by only about one-tenth of one percentage point in the relatively poor countries, where as this coefficient is about two-thirds of one percentage point in the relatively rich countries (Ogaki et al 1996). Fourth, even at relatively high levels of income, financial reforms which ease borrowing constraints may stimulate consumption rather than savings (Hall

1978, Jappelli and Pagano, 1989, 1994).

Finally, increased interest rates may restrict the ability of the corporate sector to restructure production methods and hence its productivity and growth. And if the savings propensity of the household sector is lower than that of the corporate sector total savings may decline (Singh, 1993).

On theoretical grounds, it has been postulated that a relaxation of liquidity constraints will be associated with a consumption boom and a decline in aggregate saving. More specifically, Campbell and Mankiw (1990) postulated that there are two types of households in the economy: the first type of household, x , is liquidity constrained and their consumption is entirely determined by the evolution of current income, while the second type ($1-x$), has free access to capital markets and can smooth their consumption inter-temporarily. Such a theoretical development led these authors to challenge the implicit McKinnon-Shaw assumptions that were based on a homogenous household set in which it was assumed that all relevant households had free access to capital markets within the domestic economy. This argument stemmed from the Stone-Geary utility function where the inter-temporal elasticity of substitution, which determines the sensitivity of consumption to real interest rates, is determined by permanent income and subsistence consumption. Thus, increases in real interest rates will affect consumption/saving decisions in varying degrees. In countries where the representative household is close to subsistence consumption (and saving), they may not be sensitive to changes in the real rate of interest. Only in wealthier countries would consumption decline (and saving

increase) following an increase in real interest rates. Hence, in this analysis the magnitude of the increase in saving following the higher real interest rates associated with financial liberalization will depend on the level of income.

Financial reforms, however, may stimulate financial savings in other ways than through an increase in interest rates. A reduction in controls on the financial system along with increased competition and improved customer service may result in increased savings. Access to savings instruments may not only enhance the willingness to save but also result in the substitution of financial savings for investments in assets such as gold and jewellery. One other aspect of financial reforms, which may influence household savings, is taxation. Reforms which reduce high marginal income tax rates and increase disposable incomes may not only serve to eliminate tax evasion but also stimulate savings. Tax reforms designed to reduce tariffs on trade and excise duties, however, may encourage consumption and reduce savings.

Yet another issue which has aroused considerable discussion relates to the impact of reforms on public savings defined to include current surpluses of public administration and publicly owned enterprises. The seemingly obvious proposition here is that reforms which tend to reduce the profligacy of the public sector would increase public savings and hence total savings. The much discussed Ricardian equivalence theorem, however, argues that an increase in public savings may be offset by an equivalent reduction in private savings leaving the total volume of savings unchanged. The Ricardian equivalence theorem rests on a number of assumptions such as well-

functioning capital markets, perfect information, an independent banking sector free of government imposed restrictions, none of which may hold in developing countries. In any case, empirical evidence in support of the theorem is weak. Most studies detect a very weak negative relationship between public and private savings (Edwards 1995, Corbo and Schmidt-Hebbel 1991). Indeed, increased public savings may promote total volume of savings. The experience of the East Asian countries suggests as much.

Most studies on economic liberalization analyze the impact of exports and foreign direct investment on growth, but not on savings (Greenaway et al 1997). It is likely that relatively liberal foreign trade regimes promote savings. Typically, the savings rate tends to be high in relatively open economies such as the East Asian economies. Liberal foreign trade regimes may promote savings for a number of reasons. Import competition may serve to reduce the prices of consumer durables, so too would increase flows of foreign investment in these industries. The resulting increase in real incomes may promote savings, provided both the income and substitution effects of a growth in income work in favour of savings as opposed to consumption. Liberalization of the foreign trade regime may promote competition and efficiency with a benign impact on growth and hence savings. Also, increased exports may result in increased savings if the propensity to save from export incomes is relatively high. Equally remittances from expatriates abroad may increase with economic reforms, as has happened in Nigeria, and promote savings.

The empirical results, however, have not been consistent across countries. Hussain (1996) estimated that, in the

three years following reforms, savings in Egypt increased by about 6 percent of GDP over the level that would have occurred in the absence of financial liberalization. However, Bayoumi (1993a) showed that financial deregulation in the United Kingdom led to a decline in the personal savings ratio of 2.3 percentage points over the 1980s. Chapple (1991) also reported a decline in both household and corporate savings in New Zealand following liberalization. Evidence from Turkey during the 1970s and 1980s demonstrated that a negative income effect from higher interest rates outweighed the positive substitution effect on the private savings rate (Uygur, 1993).

Financial liberalization has also been shown to lead to consumption boom and consumer lending in a number of countries, including, the United Kingdom (Bayoumi, 1993b), Mexico, and Thailand. Using the overlapping generation framework, Bayoumi (1993b) has shown that a move from a financially regulated to a deregulated system will make savings more sensitive to changes in income, wealth, demographics, and real interest rates. In addition, there will be a transitional decline in savings associated with higher real interest rates and a larger current account deficit. While transitional, the duration of this effect depends upon overlapping generations within the economy. In summary, there is conflicting evidence in the literature regarding the impact of financial liberalization and savings mobilization.

In sum, there are no settled conclusions on the impact of financial liberalization on the savings rate. The one proposition which seems to be robust is that liberalization is likely to

promote savings because of its impact on growth and not the other way round. Nigeria's experience provides an opportunity to test this proposition. Unfortunately, not all of the propositions in the literature on economic liberalization and savings can be empirically tested. Some of the variables cannot be quantified, and for some others data in the required form are not available. This study utilizes available data for Nigeria to assess the impact of financial sector reforms on savings mobilization.

3.0 Financial Sector Reforms in Nigeria²

At the commencement of comprehensive financial sector reform in Nigeria in 1987, the sector was highly repressed. Interest rate controls, selective credit guidelines, ceilings on credit expansion and use of reserve requirements and other direct monetary control instruments were archetypal characteristics of the financial system. Access into banking business was limited and government-owned banks dominated the industry. The reform of the foreign exchange market which until then was also controlled began in 1986. Indeed the financial sector reform was a component of the comprehensive economic reforms programme, Structural Adjustment Program (SAP) which was adopted in 1986.

The main financial sector reform policies applied were deregulation of interest rates, exchange rate and access into banking business. Other reform measures included, establishment of Nigeria Deposit Insurance Corporation, strengthening the regulatory and supervisory institutions, upward review of capital adequacy standards, capital market deregulation and introduction of indirect monetary policy instruments.

Some distressed banks were liquidated while the central bank took over the management of others. Government share holdings in some banks were also sold to the private sector. (See Nnana, 2002 for the details and the sequencing of the reform measures)

The Central Bank of Nigeria made attempts at restructuring the financial system prior to the introduction of open market operations in 1993. Bank deposit and lending rates were deregulated at the beginning of the structural adjustment programme in 1987. In 1991, the CBN in a reaction to rising nominal lending rates in the market for loans prescribed a maximum margin between the bank's average cost of funds and their maximum lending rates as well as a minimum level for their savings deposit rates. Interest rate determination was still supposed to be market-related through its link to the cost of funds.

In order to promote competition in the money market, the procedure for licensing new banks was streamlined and liberalised. Consequently, the number of banking institutions increased from 50 in 1987 to 120 in 1993, dropped to 115 in 1996. By 1998, the number of banks surged to 155, however in 2004, the number plummeted to 89. An auction-based system for issuing treasury bills and certificates (both government debt instruments) and the issue of these instruments as Treasury bearer bonds to enhance tradability was introduced. This delinking of the treasury bill rate from the MRR was aimed at improving the efficiency of public debt management and the conduct of monetary policy, enhancement of investor interest and involvement in the holding of government debt

²This section benefited immensely from Onwioduokit and Adamu (2005).

instruments, promoting greater reliance on market forces in the determination of yields on the instruments and encouraging the development of the secondary market for government short-term debt instruments.

The CBN Decree No. 24 and The Banks and Other Financial Institutions Decree (BOFID) No. 25 were promulgated in 1991. The Decrees enhanced the central Bank of Nigeria's independence in the conduct of monetary policy, augmented the CBN's regulatory and supervisory power over banks and brought under the purview of the CBN the licensing and supervision of other non-financial institutions like Discount and Finance Houses. The Decrees empowered the central bank to apply indirect monetary policy instruments such as open market operations (OMO), reserve requirements, stabilisation securities and special deposits to achieve the objectives of monetary policy.

Furthermore, prudential guidelines regarding ample provisions for bad and doubtful debts and loan classification, interest capitalisation, capital adequacy and limits on loan concentration were put in place in 1990. In order to mitigate the adverse effects of the implementation of the guidelines on banks' balance sheets, the central bank later allowed banks to write off accumulated bad and doubtful debts over a phased period of four years. Steps were also taken to strengthen the capital bases of banks. The minimum paid-up capital of banks was increased from N20, 000,000 to N50, 000,000 million in the case of commercial banks and N12, 000,000 to N40, 000,000 million in the case of merchant banks with effect from June 1992. In 2001, the central bank of Nigeria adopted the universal banking policy, thereby abrogating the

classification of banks by the nature of their business that existed hitherto. Again to ensure that banking contribute to the real economy and not just serve as trading post, the Central bank of Nigeria increased the required capital of banks to N25.00 billion effective December, 2005.

In order to facilitate the development of a secondary market for government debt instruments so as to reducing government dependence on the CBN financing of its deficit, three discount houses were licensed in 1992. In addition to intermediating funds among financial institutions, the discount houses were also expected to promote primary and secondary markets for government securities.

In 1990, the central bank in conjunction with the Nigerian Deposit Insurance Corporation (NDIC) commenced the process of bank restructuring. At first, six insolvent banks were identified and were allowed self-restructuring under the close supervision of the two supervisory authorities, the CBN and NDIC. In late 1992, a joint committee of the CBN and NDIC involving a sector of the BOFID assumed greater control over distressed banks. Banks thus taken over by the CBN had their board of directors dissolved and an interim management board appointed to exercise powers normally vested in a board of directors of a bank and some turn-around measures, including the down-sizing of operations through rationalisation of staff and branch-network. The Boards are also empowered to appoint independent firms of auditors to ascertain the true financial condition of each of the banks. Thereafter, appropriate restructuring or liquidation options were to be adopted.

However, in September 1992, credit ceilings on banks that are adjudged

healthy by the CBN were lifted. A bank was considered healthy if it met CBN guidelines on certain specified criteria in the preceding three months. These criteria were; cash reserve, liquidity ratio, prudential guidelines, statutory minimum paid-up capital, capital adequacy ratio, and sound management. With the application of these criteria about 80 banks were endorsed as healthy and exempted from credit ceilings. These same criteria were applied for determining banks that qualify to participate in the official foreign exchange market.

An intriguing element of Nigeria's foreign exchange market was the irregularity in policy implementation. The reform of the foreign exchange market for instance started in 1986 with the abrogation of exchange controls and establishment of a market-based autonomous foreign exchange market, including the licensing of Bureaux de change in 1988. However, a fixed official exchange rate existed alongside the autonomous market. In 1993 the plodding market-based depreciation in the official exchange rate was abridged by a sharp devaluation in a bid to close the gap between the official and the autonomous exchange rate. Discontented with the gap between the official and autonomous exchange rates, government prohibited the autonomous foreign exchange market and reintroduced exchange controls in 1994. But after a full year of exchange controls, the autonomous market was reintroduced in 1995. A foreign exchange subsidy of about 300 per cent, representing the gap between the official and autonomous market rates existed for some government-preferred consumption, including pilgrimage and sporting events. The continued operation of the official exchange rate exerted distortions in the domestic allocation of resources in the public

sector. Fiscal gains thus appear to be an incentive factor in retaining the current structure of the foreign exchange market. A similar pattern of policy somersault was apparent in the interest rate reforms policy. First introduced in 1987, the market-determined interest rates operated until 1991 when interest rates were capped. However, a year after, deregulation of interest rates policy was once again re-introduced in 1992 and 1993. Although indirect monetary instruments (open market operations) were initiated in 1993, some measures of controls such as sectoral credit allocation guidelines continued to be applied in 1994.

Regarding bank licensing and regulation, the reform commenced with the deregulation of bank licensing in 1987. This resulted in the establishment of many new banks. However, when prudential measures such as, the increase in the required banks paid up capital in 1989 and the reform of their accounting procedure (1990) appeared insufficient to restrain the immoderation of the sector, government placed total embargo on bank licensing in 1991. Privatization of banks was suspended after applying the measure to a few

banks. Some of the issues highlighted above point to the disorderly manner in which the reform has been implemented in Nigeria. Thus, Nigeria's financial sector reform has not been a smooth sailing process. This in itself could obscure the appraisal as well as its outcome.

4.0 IMPACT OF FINANCIAL SECTOR REFORMS ON SAVINGS IN NIGERIA.

A fascinating exercise is to assess the effects of liberalization on the measures of financial development that in turn are regarded as correlating with economic growth. Development of the financial sector requires a set of indicators that can be used for effective policy formulation, implementation and evaluation. As such, there is no precise definition in the literature of 'financial sector development'. However Fry (1978) observes that the key to financial sector development is the reduction, and ultimately unification, of the fragmented financial markets. This involves a complete set of indicators mainly covering credit intermediation, liquidity management and the risk management characteristics of the financial system. Goldsmith (1969)

used a set of measures, which he called the 'financial interrelations ratio', in tracing the close relationship between the financial sector and economic development. In many other studies, the ratio of the broad money (M2) to GDP is taken to observe the changes in the size of the financial system relative to the size of the economy.

It is hard to find 'an indicator' that can directly measure the development of the financial sector. We therefore analyse the roles of the indicators that are studied in the recent literature and then choose ten indicators that encompass all the qualities of a well-developed financial sector. The six measures are explained as follows: Broad Money as a ratio of Gross Domestic Product (GDP), Private Credit as a ratio of GDP, Currency Outside Bank as a ratio of Broad Money (M2), Interest Rate Spread, Real Interest Rate, and Gross Savings as a ratio of GDP. The data for the analysis were essentially sourced from the central bank of Nigeria. The assessment period is broken into two segments 1980-1986 representing the pre-reforms era, while 1987-2005 represents the post reforms era.

TABLE 1: FINANCIAL SECTOR REFORMS INDICATORS IN NIGERIA: 1980-2005

| | Pre-Reforms 1980-1986 | Post-Reforms 1987-2005 |
|---------------------------|----------------------------------|-----------------------------------|
| M2/GDP (%) | 26.7 | 22.8 |
| Private Sector Credit/GDP | 16.8 | 14.4 |
| Currency outside Bank/M2 | 23.0 | 25.7 |
| Interest Rate Spread | 1.8 | 10.7 |
| Real Interest Rate | -8.1 | -15.5 |
| Gross Savings/GDP | 7.1 | 12.6 |

One of the expected effects of financial sector liberalisation according to theory and some empirical findings is what have been known in the liberalisation literature as Financial Deepening, usually measured as the ratio of broad money to the GDP. In Nigeria the ratio worsened from 26.7 per cent in the pre-reform era to 22.8 per cent in the reform era. This clearly indicated that financial sector reforms in Nigeria did not achieve the purpose of financial deepening that is purported by theory. This outcome is consistent with the findings of Nissanke and Aryeetey (1998) who observed that expected positive effects from liberalisation, in savings mobilisation and credit allocation had been slow to emerge. The use of both the M2/GDP ratio and the private credit/GDP ratio to measure financial deepening showed no clear upward trend in any of those countries. In Nigeria, both indicators worsened considerably in the reform period. Indeed, in most countries, credit as a proportion of GDP declined in the reform years, even if the share of credit to the private sector rose.

The ratio of credit to the private sector to GDP has been classified as a measurement of financial sector widening (De Gregorio and Guidotti (1993). Thus, the higher the ratio the more widened the financial sector is assumed to be. The reasoning underpinning such assumption is that the private sector utilisation of credit is usually more efficient than the government sector. In the pre-reform period, the ratio stood at 16.8 per cent. However the ratio deteriorated to 14.4 per cent during the post reform era, indicating relative narrowing of the financial sector in Nigeria. This is very instructive as it contradicts the much-touted impact of Nigeria's financial sector in economic development. Confirming what some researchers, including Onwioduokit, (2002) refers

to as nominal growth in the numbers of banks that did not affect the financial sector positively, much less the economy.

This ratio measures cash intensity in the economy. One of the expected gains of the financial sector liberalisation was the development of the financial system that would improve banking habits and by extension the development of the payments system. The performance of the Nigeria's financial reforms under this criterion indicated a deteriorating trend. During the pre-reform period, this ratio was 23.04 per cent. This performance was broadly in line with the Africa average of 23.5 per cent by 1985. However, post liberalisation ratio at 25.71 per cent in 2003 did not only indicate a worsening trend compared to the pre-liberalisation level but was also more out of line with Africa's average of 22.5 per cent in 2003 than in 1985 (see Lindgren and Odonye, 2003). Overall, the results showed that cash intensity in Nigeria in 2003 was more severe than in 1985. The worsening trend could also be adduced to central bank of Nigeria's policy of introducing higher currency denominations supposedly to keep pace with inflation. Indeed between 1985 and 2003, about four different higher naira denominations ranging from N50 to N500 were introduced. Furthermore the absence of relevant legal regulations to which issues such as dud cheques, until very recently could have contributed to the observed outcome.

The financial sector reforms and liberalization was expected to narrow the spread between deposit and lending rate as a result of competition that was expected to ensue in the financial sector. The interest rate spread (lending savings margins) has been dramatically high in Nigeria

in the post reform period than in the pre-reforms era. The prevalence of very high lending rates and systematic increase in the lending-deposit rate margins in the post reforms period is essentially unacceptable. Under the reform programmes, an initial increase in the spread between lending and deposit rates was expected, as banks needed time to adjust their cost structures during the changing environment. The spread was expected to narrow as more efficient business practices were embraced sequence to increasing competition and as credit demand stabilised. But more than a decade after reforms were started, the spread between the two continue to widen in Nigeria. The problem of continual increases in lending rates and low deposit rates during the post reform period is one of the most attention-grabbing effects of financial sector reforms in Nigeria. For instance the spread widened by over 8.9 percentage points on the average from 1.8 per cent during the pre-reforms period to 10.7 per cent in the post reform period.

Real Interest Rate

Real interest rate is usually used to proxy the efficiency of financial intermediation. Financial liberalization is expected to deliver higher real interest rates, reflecting the allocation of capital toward more productive, higher return projects owing to a shift to more productive uses of financial resources and enhanced financial intermediation. However in Nigeria the average real interest rate deteriorated from negative 8.1 per cent during the pre-liberalisation period to negative 15.5 per cent during the post liberalisation era. Thus during both pre and post liberalisation era in Nigeria, the real interest rate were negative, reflecting the high rate of inflation associated with fiscal

prolificacy of the military government that dominated most of the period of both pre and post liberalisation in Nigeria. However the post liberalisation era as noted earlier recorded a worsening trend than the pre liberalisation period.

Gross Savings as a ratio of GDP

Gross savings as a ratio of GDP is a direct measure of savings mobilisation in an economy. It is expected that the ratio should improve with improvement in financial intermediation activity of the financial system. On the average the ratio was 7.12 per cent in the control period, but improved to 12.62 per cent during the deregulation era. This was one of the few dividends of deregulation of the financial system in Nigeria.

5 . 0 S U M M A R Y A N D C O N C L U S I O N

The main objective of this paper was to assess the impact of financial sector reforms in Nigeria, especially on the development of the financial sector. Accordingly, this paper dwells on theoretical issues and brief review of literature and presented a brief analysis of financial sector reforms in Nigeria. Attempt was also made to assess the impact of the reforms. The paper analyzed the roles of the indicators that are studied in the recent literature. Ten indicators that encompass all the qualities of a well-developed financial sector were selected to measure the impact of financial sector deregulation on the economy. The six measures included: Broad Money as a ratio of Gross Domestic Product (GDP), Private Credit as a ratio of GDP, Currency Outside Bank as a ratio of Broad Money (M2), Interest Rate Spread,

Real Interest Rate, and Gross Savings as a ratio of the data for the analysis were essentially sourced from the central bank of Nigeria. The assessment period is broken into two segments 1980-1986 representing the pre-reforms era, while 1987-2003 represents the post reforms era. The assessment based on the chosen indices showed that Nigeria's financial sector reforms only impacted positively on two out of the ten indicators compared with the pre-reforms era.

A battery of explanations has been advanced for the obvious failure of financial liberalisation programmes to address the problems of Nigeria's financial system. The most recurrent rationalization is the incompleteness of the reforms. It is argued that the persistent poor financial performance was due to lack of progress on some of the reform measures. Blame was placed on the continued use of financial systems to finance public sector activities, which was made possible by the continuing public sector ownership of a large part of the financial system (World Bank, 1994).

Soyibo (1996) opines that improper pace and sequencing in the initial reform years led to the crisis and eventual collapse of the financial system, necessitating several policy reversals in Nigeria. The crisis made policy consistency and credibility critical issues. It is obvious that Nigeria's difficulty in sustaining a consistent policy stance was partly attributable to unstable general economic and political conditions. Stein and Lewis (1996) have ascribed the failure of financial liberalisation in Nigeria largely to the political and institutional setting of reforms. The argument for this position is that the

abrupt financial liberalisation led to the development of opportunities for speculative rent seeking that replaced traditional forms of rent-seeking that are based on political patronage. In sum, the faulty design of the reform programme, with respect to timing, pace and sequencing led to instability. World Bank (1994) notes that complete interest-rate deregulation should only be attempted when certain stern criteria are satisfied. Thus, in addition to stable macroeconomic conditions and adequate regulatory and supervisory arrangement, it is important that more sophisticated and solvent banking institutions with positive net worth in contestable financial markets are present. It is expected that interest rate deregulation will be ineffective where these conditions are not met. In the absence of such an environment, interest rates may be managed in the interim, moving to market-determined rates within a longer time frame.

In conclusion it is obvious that the financial system will continue to flourish without adequately affecting the real economy even in the era of deregulation if the banks in particular, continue to trade in foreign exchange and finance trading activities at the expense of the manufacturing sector. Again the fiscal operation of government that resulted in persistent deficits mainly financed by the central bank in most of the liberalisation era that resulted in very high inflation, adversely affected macroeconomic stability, setting in motion a vicious cycle of external and internal imbalances. The consolidation of the banking system currently embarked upon by the central bank should be pursued to a logical conclusion if the financial sector in Nigeria is to develop appropriately.

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