

## THE ROLE OF THE CENTRAL BANK IN THE NIGERIAN ECONOMY\*

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I am pleased to have the privilege, once again, of addressing this august assembly on the occasion of the Institute's Annual Dinner. It is also convenient for me to be allowed, in keeping with tradition, to select the theme of this Address. The Institute's Annual Dinner has always provided the Governor a unique opportunity of presenting an address on a topical and leading issue of interest to the financial services industry. I am sure that this year will not be an exception. Given the unstable macroeconomic environment which has prevailed in Nigeria in the last few years and the great interest and concern this has generated among professionals and the general public, I consider it appropriate to focus my presentation on **The Role of the Central Bank in the Nigerian Economy**, with a view to highlighting the Bank's responsibilities and its contributions within the broad context of macroeconomic management in the country. In this connection, I welcome this opportunity to put matters in their proper perspectives, having regard to the spate of criticisms levelled against the Central Bank of Nigeria [CBN] for the prolonged unhealthy state of the Nigerian economy.

### 1. BACKGROUND

2. For a start, let me provide some background to my Address. In this regard, I wish to state that the objectives of a central bank are broadly the same world-wide and may be classified into two categories. First, a central bank is commonly viewed in terms of its traditional functions as the issuer of currency, banker to the government, controller of credit, a lender of last resort and supervisor of banks. Second, a central bank can be perceived as a motivator of the financial sector and a promoter of general economic development. It is, however, incorrect, to view these two broad goals -- monetary stabilization and promotion of economic development -- as mutually exclusive as they indeed reinforce each other with monetary stability forming the basis of sustainable growth. In developed economies, attention of central banks is focused on short term macroeconomic stabilization, but it is now the vogue, even in these economies, for such actions to be used to influence basic national development objectives. Understandably, a central bank in a developing economy is usually mandated to pursue the two broad goals, and more often than not, is perceived,

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though erroneously, by the general public as the prime mover of the economy. In whatever setting the central bank operates, its actual performance is determined largely by its enabling legal framework, the institutional structure of the financial sector which is its primary constituency, and the macroeconomic environment. I wish to apply these broad statements to the Nigeria context in the next part of my Address.

## **II. DETERMINANTS OF THE ROLE OF THE CBN IN A DYNAMIC ENVIRONMENT**

3. Since its establishment in 1958, the objectives of the CBN, as outlined in the enabling laws, have remained broadly the same, but the arrangements and strategies for achieving the objectives have changed in scope and character. In general, the methods of achieving its objectives have widened in consonance with the dynamics of the legal, institutional and macro-economic environments.
4. Legislative changes have produced a tremendous impact on the operations of the Bank. The main sources, as you are all aware, of the CBN's legal authority are the CBN Decree No. 24 of 1991 and the Banks and Other Financial Institutions Decree [BOFID] No. 25 of 1991 which replaced the CBN Act of 1958 and the Banking Decree of 1969 [and their various amendments]. While the earlier legislations tended to erode the authority of the CBN with regard to the execution of its primary mandate, the 1991 legislations attempted to reverse that trend and support the widened scope of the Bank's activities. The legislations rationalised the series of financial sector reforms initiated since 1986 and enhanced the Bank's power of surveillance over the financial sector. Another notable change in the legal framework was the Bank's direct access to the Presidency instead of through the Minister of Finance, which has enhanced consideration of its advice by the highest authority of government.
5. The effect of the rapid growth of the financial sector on the Bank's operations has also been pervasive. The Nigerian financial sector has expanded tremendously since 1958 and the Bank has had to modify the nature and style of its surveillance. For instance, let me cite the example of the rapid growth of commercial and merchant banks – the primary institutions of the sector. In 1960, there were only 13 of these banks with 190 branches. In 1985, the number of the banks had increased to 40 while their branch network expanded to 1,323. By 1993, these were 120 banks with a branch network of 2,479. Apart from commercial and merchant banks, the number of other financial institutions has increased, while some of them, such as the People's Bank of Nigeria, community banks, primary mortgage finance institutions and finance companies have emerged and experienced even more rapid growth than the conventional institutions. In response, the CBN has grown in size and structure and modified its approach to financial sector regulation and surveillance.
6. By far the greatest influence on Bank's operations has been produced by the

structural changes in the economy. The Nigerian economy has expanded significantly especially since 1970. The nature and scope of economic management have varied widely. In the early 1960s, economic management was relatively less dependent on control mechanisms. However, between the start of the civil war and 1985, government involvement in the economy increased substantially and this was accompanied by the increased use of control instruments. The control instruments introduced serious distortions over time into the economy but were popular and sustained by the availability of substantial foreign exchange resources. As these resources diminished rapidly, especially in the early 1980s, the control instruments became increasingly counter-productive. By 1986, they became unsustainable and were largely dismantled as part of the comprehensive macroeconomic policy reform programme popularly called SAP.

- 7 Significant gains were made during the reform, but some distortions remained largely because of the negative impact of unduly expansionary government fiscal operations. Again in 1994, economic management has, after a fairly long period of deregulation, shifted to the use of control instruments.
- 8 The massive changes in macroeconomic management characterised by frequent policy reversals, have produced a significant influence on CBN response and operations. The Bank built up a large bureaucracy to support the control mechanisms from the mid-1960s and became literally overwhelmed in managing the huge increase in the number of accounts and the limited foreign exchange resources, as well as the rapid growth in domestic liquidity and the external debt stock. On the whole, it responded adequately to the economic reform programme from 1986, especially in the areas of foreign exchange and debt management and monetary control. Just as it was getting used to managing an emerging market-based financial sector and had indeed largely dismantled the control apparatus, it has become involved once more in 1994 in the execution of the new control-based economic management regime.

### III. APPRAISAL OF CBN'S PERFORMANCE

9. Given the dynamic changes in the Nigerian economy outlined earlier, I wish now in this part of my Address to undertake an appraisal of CBN's performance under those circumstances. In this connection, I shall sketch its activities in historical perspective, assess the impact on the macroeconomy and identify the achievements and constraints.

#### **Role of the CBN in Historical Perspective**

10. The CBN has always been deeply committed to the execution of its traditional functions aimed primarily at stabilizing the economy. The period up to 1981 could be described as the golden period. The Bank introduced the first national currency in 1959 and made several changes in its design, including those in 1965, 1968, 1973, 1977 and 1979. In managing the external reserves, the Bank

during this period successfully maintained an adequate level of reserves which preserved the international value of the national currency. With adequate external reserves, the administrative determination of the exchange rate appeared appropriate. Monetary control was largely effective although the control instruments made this exercise increasingly more difficult. The growth of the financial sector was modest which made the Bank's surveillance relatively effective. In its capacity as banker and adviser to the government, the Bank kept government finances professionally and initiated a framework for domestic debt management. It also offered useful advice through its monetary policy proposals, the annual budgets and its membership of national committees.

11. In the area of promoting financial institutions and markets during the period up to 1981, the Bank's role was significant in shaping the course of economic growth and development. In the money market, for instance, the Bank introduced several instruments designed to raise government revenue and mobilize short-term financial resources for development. In the capital market, the Bank actively supported the establishment of the Nigerian Stock Exchange and the Nigerian Securities and Exchange Commission. Furthermore, the Bank co-sponsored the establishment of specialised financial institutions providing long-term finance for industrial, commercial and agricultural activities. Notable examples are the NIDB, NBCI, NACB, FMBN and the ACGS Fund.
12. You will all agree with me that economic developments in Nigeria since 1981 have been significant. We have witnessed the rapid downturn in the early 1980s, the bold efforts to reverse the trends through the economic reform programme, the seeming failure of the reform programme to arrest the trends and the apparent return to the use of economic controls. It is not my intention to bore you with the details of the Bank's activities during this period, but to indicate in outline its role in the effort to arrest economic downturn. Before the launching of the reform programme in 1986, the Bank was particularly active in getting government to modify its style of economic management when it was clear that the existing strategy had failed. After the programme was adopted in 1986, the Bank played a critical supporting role, especially in managing the new Foreign Exchange Market; designing the programme of reform for the market-oriented financial sector; introducing a new system of market-based monetary management with Open Market Operations [OMO] as the main instrument of control; stemming the growth of domestic liquidity at critical periods, active support in the management of the bulging external debt; managing the domestic debt of the Federal Government and coping with the increasing level of financial distress and erosion of confidence in the financial sector.
13. Indeed, the role of the Bank during this period in the execution of its traditional functions was so active that it was generally misconstrued that the Structural Adjustment Programme was the "baby" of the Bank. Consequently, all the

problems observed with the implementation of the programme were blamed on the Bank even when there were indications that the fundamental factors could not be directly traced to the failings of the Bank's traditional functions.

14. I do not wish to give the impression that the CBN has been concerned with only its traditional functions since 1991. Indeed, it continued to support the growth of the financial sector and to promote economic development generally. During the reform programme, for instance, the Bank actively participated in promoting a number of innovative financial institutions and financing schemes, notably the Nigeria Deposit Insurance Corporation [NDIC], the Nigerian Export Import Bank (NEXIM), the Small and Medium Scale Enterprises Scheme (SME), the National Economic Reconstruction Fund (NERFUND), the Refinancing and Rediscounting Facility and the Export Stimulation Loan (ESL). In 1991, the Bank successfully completed the Rural Banking Programme under which, in three phases, a total of 765 rural bank branches out of the 766 allocated to banks were opened throughout the country. The Bank, through these institutions and funds, sought to increase the surveillance over the financial sector, enhance savings mobilization, promote production for export and encourage the growth of small scale enterprises. In addition, the Bank continued to give active support to the development finance institutions, as well as the re-orientation of the money and capital markets in order to enhance allocative efficiency.

### **Impact of CBN's Activities on the Economy**

15. Distinguished Ladies and Gentlemen, turning now to the impact of CBN's policies and activities on the economy, I wish to concede that it is the achievement of the ultimate targets of economic policy that is the most relevant criterion. In this regard, we are all aware that the ultimate goals of macroeconomic stability and sustainable growth have so far remained elusive. The inflation rate has been high and unstable, the balance of payments has been more in deficit than in surplus, while economic growth, after some recovery between 1988 and 1991, has slackened in the face of persistent macroeconomic instability and low capital formation. However, I want to caution that the exact impact of CBN's policies on the ultimate targets of economic policy is generally difficult to establish owing to the fact that monetary and banking policy measures are usually employed in combination with other policies, including fiscal, trade, exchange rate and incomes policies. In addition, there are also the effects of purely exogenous factors. For these reasons, I wish to focus attention on the impact of CBN's actions on the intermediate target variable – monetary aggregates, interest and exchange rates.
16. The highly unstable macroeconomic environment in recent years has been characterised by the excessive growth in monetary aggregates as the growth of narrow money, M1, remained substantially way off target especially since 1988. In fact, the worst years in terms of policy slippages were 1988, 1990,

1992 and 1993 when the divergences between the targeted M1 growth rate and actual performance were 26.9, 31.9, 32.8 and 34.6 percentage points, respectively. The ability of the CBN in regulating the money supply over the years has been dictated to a large extent by the magnitude of Government's fiscal deficit and the mode of financing it. The excessive growth in private sector credit, and foreign assets monetization have, to a lesser degree, also exerted some expansionary influence. Money supply growth was moderate in those years when net claims on the Government rose only moderately or declined as happened in 1986, 1987 and 1989, while the rapid increases in 1988, 1991, 1992 and 1993 were associated with relatively large increases in credit (net) to the sector.

17. It should be emphasized that the bulk of credit to Government has come from the CBN and was therefore highly inflationary. The acceleration in money supply growth in 1990, on the other hand, reflected substantially the monetization of oil receipts. Although bank credit to the private sector was always a significant expansionary factor, large enough in every year except 1989 to drive money supply beyond the M1 target, the dominance of Government was overwhelming. In 1994, however, available data indicate that commercial and merchant banks' credit to the private sector exhibited unprecedented growth, having risen by 76.9 and 79.1 per cent, respectively, in the first six months, compared with the growth rates of 22.6 and 17 per cent in the corresponding period a year earlier, owing largely to increased foreign exchange demand by private economic agents under the existing foreign exchange and interest rate policies.
18. Market interest rates rose steeply in the environment of high and unstable inflation rates and as a result of actions taken by the Monetary Authorities to counter large injections of liquidity arising from the financing of government deficit. Despite the sharp rise in nominal rates, real rates of interest remained negative in 1988 and 1989 and from 1992, owing to rising inflation with adverse implications for saving mobilization and domestic investment. The government thus intervened again in 1994, pegging deposit and maximum lending rates of all financial institutions at 12-15 and 21 per cent, respectively, in order to halt the adverse trends as well as evolve a more appropriate interest rate regime.
19. With respect to the exchange rate, the Naira has depreciated almost persistently since SAP. Except in 1986 and 1987 when the large depreciation resulted from the previous over valuation of the currency, movements in the exchange rate have been influenced by the high level of aggregate demand relative to supply, and speculation.
20. With the increasing incidence of financial sector distress, the regulatory/supervisory capacity of the Central Bank has increasingly been called to question. There are those who assert that the regulatory authorities had not done enough to protect depositors and other creditors from the menace

of imprudent and fraudulent operators and bring them to book. While I acknowledge that more needs to be done by the regulatory/supervisory authorities to ensure the safety, soundness and efficiency of the financial services industry, that task cannot be undertaken by the regulatory/supervisory authorities alone. The action or lack of it by these agencies should be seen in the context of macroeconomic and policy instability; economic recession; the distortions in the system; unsafe and unsound banking practices by operators; insider dealing and abuses; the indifference or negligence of directors and shareholders; the greed of investors; and the failure of sanctions. Consequently, it is unfair to hold the regulatory/supervisory authorities for what is manifestly part of the generalised societal indiscipline in the country. Viewed in this light, rescuing the financial system requires the collaborative endeavours of Government through the political will; the regulatory authorities through capacity building and robust supervisory intervention; the financial institutions by adopting more prudent and efficient banking practices and self-regulation; the law enforcement agents by bringing offenders to book; and the banking public should be less gullible in reaching to manifestly unrealistic investment offers.

### **Overall Assessment of CBN's Role**

21. A less than objective appraisal of the CBN's role in the Nigerian economy could interpret the basis of the above adverse macroeconomic and sectoral trends as evidence of failure on the part of the CBN. If it is accepted that, as stated earlier, macroeconomic policies are usually executed by various agencies in collaborative efforts, the failures of such policies should be correctly traced to the nature of the national economic management system. Furthermore, I should like to argue that the ultimate effects of many of the Bank's actions in recent years would have their potential benefits manifest in the future as the prevailing environment could only have permitted only limited short-term gains.
22. Yet, these short-term gains are noteworthy. A liberal financial sector which the CBN has assiduously fashioned out since 1986 is essential for the nation's growth and development. The supervisory and prudential role effectively assumed by the Bank will pay off in the medium to long term through inspiring greater public confidence in financial institutions. The Bank's role in giving expert advice and the dissemination of research results and wide-ranging information on the economy is one that the Management of the Bank feels happy and even proud about. Another contribution worthy of mention has been the Bank's role in the training of manpower for the financial services industry. Its Training Centre is about the largest for any Central Bank in Sub-Saharan Africa. The Bank's support for other training institutions in the financial sector and other areas of the economy such as FITC, CIBN, NCEMA, professional associations and the Universities is also substantial. This role in capacity

building is important and should be seen in the context of helping to resolve the critical bottleneck in extending financial intermediation. Recently, the CBN took the initiative in bringing about the establishment of the Financial Services Regulation Co-ordinating Committee intended to harmonise and strengthen supervisory activity.

### **Constraints on CBN's Performance**

23. Obviously, the CBN has made significant contributions to the growth of the Nigerian economy and as I said earlier, the full impact of its recent actions will only materialise in the future. This is not to deny that the Bank has serious constraints in the performance of its functions. These have been well-articulated in the Bank's numerous submissions and are very well known by concerned professionals like yourselves. However, for completeness and emphasis, I should like to highlight them here. The first constraint has been the persistence of large government deficits and their financing by the CBN. This mode of deficit financing increases the monetary base and swells the level of excess liquidity in the banking system with adverse implications for the naira exchange rate and domestic prices. When the CBN inevitably acts to reduce the excess liquidity through, for instance, the issuance of stabilization securities since 1990, the money market is destabilised with a lot of pressure put on interest rates. The second main constraint is the prevalence of policy inconsistency and instability. In the last few years, monetary policy outcomes have been largely at variance with targets. Policy reversals in respect of exchange and interest rates are well known to you. There is a third related constraint, namely, inadequate co-ordination of policy implementation which has impacted negatively on the productive sectors.
24. The fourth constraint is the pervasive intervention by government in the financial sector. Indeed, such intervention has resulted in the proliferation of regulatory authorities in the sector and this has often sent conflicting signals to the public since no co-ordinating arrangement was put in place until recently. The fifth constraint is the relationship between the Bank and the Federal Government. The current legal framework which defines that relationship is certainly an improvement on the earlier one, but certain provisions constrain the Bank from taking immediate actions on issues that require such prompt response since the prior approval of government must be obtained. Also, a situation of increased lack of transparency by market participants and where the spirit of the law is not observed constrains the powers of the Bank to act decisively. Lastly, there are constraints related to inadequate statistics and infrastructure, a problem complicated by the fact that the Bank alone cannot take the remedial actions.

## **IV LOOKING TOWARDS THE FUTURE**

25. Distinguished Ladies and Gentlemen, I am inclined to believe that the CBN has

made immense contributions to the growth and development of the Nigerian economy in the last three and a half decades. It could have attained greater achievements if the constraints highlighted above had been adequately addressed. Some of the immediate steps to be taken to enhance the effectiveness of the Bank include:

- (i) appropriate amendments to the enabling laws with a view to strengthening the Bank's powers in executing some monetary and banking policy measures independently;
- (ii) strengthening the implementation of monetary policy through fiscal restraint, greater policy coordination, **policy consistency** and stability and enhancement of technological infrastructure in the financial sector; and
- (iii) review of the Bank's organisational structure and functions to make it slimmer and fitter and more focused in its policy concerns with great beneficial impact on the economy.

26. Most of the constraints outlined earlier can be minimised while the remedial actions suggested can be speedily resolved if a leading issue of international relevance is speedily addressed. This is the issue of autonomy for the Central Bank. As I indicated earlier, the existing laws are an improvement on earlier ones, but in a sense, they have merely changed the status of the Bank rather than enhanced its authority to carry out its stated functions. As you are aware, this issue is receiving the attention of government, but I should like to highlight the principles that should define Federal Government-CBN relationship in the future. The need to accord central banks some form of autonomy capable of enhancing their authority is widely recognised. The available literature cites Germany, Switzerland, U.S.A. and New Zealand as having achieved sustained price stability and economic growth owing to the relatively high degree of autonomy given to the Central Banks in those countries. In this setting, the central bank is seen as acting as an independent and objective adviser to the government to maintain macroeconomic stability. The law that gives such autonomy to the central bank should be clear and unambiguous as to the need for the central bank to perform its core functions uninhibited, thus making it unnecessary to refer urgent and important matters for determination by the government. Of course, it is important that the practice must accord with the legal provisions.
27. If the above pre-conditions prevail, I would recommend giving the so-called *instrument independence* to the CBN. This implies that after the government has set the broad objectives of economic policy, the CBN should be given the discretion to choose the appropriate instruments and when to apply them to achieve the desired objectives. Such instruments which the CBN should be allowed to manipulate appropriately include the monetary aggregates, as well as exchange and interest rates. It is, of course, important that the Bank must be allowed to continue to run its internal administration. However, I wish to emphasise that the autonomy sketched above does not amount to creating a

parallel agency to the government. The Federal Government owns the Bank and this immediately defines its ultimate relationship with the government. Periodic briefings to the Head of State and top government officials should continue as at present. Other observers have advocated, and I tend to agree with them, that the appointment of the Governor of the Bank should be sanctioned by the legislature. I will also add that the Governor of the Bank should be given the opportunity to report on the Bank's activities to the legislative body which has the advantage of subjecting the authority of the Bank to the wishes of the general public through their representatives, thereby making the Central Bank accountable to the people.

## V. CONCLUDING REMARKS

28. Mr. President, Distinguished Ladies and Gentlemen, in conclusion, I wish to assert that although the challenges which lie ahead of the CBN are enormous, if not daunting, the Bank will respond adequately if given the support to carry out its functions. Its contributions to the economy will be enhanced and its role in creating a robust financial sector will increase. Lifting my gaze and making some prognosis regarding the character of the CBN by the year 2000, I see a smaller outfit both structurally and functionally. Shed of some of its developmental activities which can effectively be taken over by other agencies, it should focus on its stabilization functions which can sustain price stability and restore full confidence to the financial sector. If given the autonomy that I have discussed earlier, it should become a more effective institution, less susceptible to political influence and gaining greater confidence of the general public.

Mr. President, Distinguished Colleagues, Ladies and Gentlemen, in concluding this Address on a note of optimism, I want to remind all of us that it is our actions that create the institutions we have. It is a challenge to all of us – the government, the CBN, financial operators and the general public – to create a Central Bank within a suitable environment that is sufficiently responsible to the needs of the economy.

**I thank you all for your kind attention.**