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# THE POLITICAL ECONOMY OF CENTRAL BANK REFORMS: THE NIGERIAN CASE

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# THE POLITICAL ECONOMY OF CENTRAL BANK REFORMS: THE NIGERIAN CASE

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*A THESIS SUBMITTED TO THE DEPARTMENT OF POLITICAL SCIENCE IN THE FACULTY OF THE SOCIAL SCIENCES IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF THE MASTER OF SCIENCE IN POLITICAL SCIENCE (PUBLIC ADMINSTRATION) OF THE UNIVERSITY OF IBADAN, NIGERIA*

*APRIL, 1998*

## CERTIFICATION

I certify that this work was carried out by ITINA, IME AARON in the Department of Political Science, University of Ibadan, Ibadan, Nigeria.

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# DEDICATION

This work is dedicated to:

The Almighty God for His love and grace has been sufficient unto me;

My parents Mr and Late Mrs A. D. Etinah for their parental love and interest in my academic pursuits; and

All loving, caring and God-fearing husbands of this generation.

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# ABSTRACT

The study evaluates the political economic effects of the Central Bank of Nigeria (CBN) reforms. This central objective was inspired by the pragmatic expectations on the CBN as an agency for the transformation and development of the political economy. The work sets about this task by examining the different internal reorganisations and changes in the relationship between the CBN and the government. Just as the establishment of the CBN which has been noted to have some underlying political objectives, the CBN reforms and activities generally have some political dimension arising from the political economy of government finance and national development.

Basically, the study observes that the current reforms in the CBN is part of the general reforms in the political economy which have been undertaken due to the downturn in the socio-economic activities. It is also noted that the success of the CBN reforms depends in part on the scale and scope of deregulation of the political economy as well as the level of democratisation in the governance processes. The activities and behaviour within the CBN are another set of factors that determine the level of achievement of the CBN reforms objectives.

The study reveals that, given the rapid expansion in socio-economic activities that has taken place in the country, and especially the financial sector, the reforms of the CBN have enhanced the ability of the bank to contain with its extending

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responsibilities. However, the level of autonomy of the apex bank has been observed to be reducing. This is seen in the light of the general power concentration that characterises the military administrations. The study thus recommends that for greater results to be realised from the reforms, a holistic approach to economic and socio-political reforms must be adopted. The results of the CBN reforms shall be improved in a democratic environment than it can ever do under the military rule because the assumptions of the free market operation are based on free and popular democracy.

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*Ime Itina,*
*April, 1998*

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# CHAPTER ONE

# INTRODUCTION

## 1.1 BACKGROUND TO THE STUDY

The central problem of Africa's underdevelopment is noted in literature to stem from the structure of African political economy. Thus, the economic crisis in Africa, of which Nigeria is part, is characterised by low productivity, weak productive base, backward technology population explosion, mass poverty, and food shortage. These plagues in Africa are basic bottlenecks that arise from the structures of production, consumption, technology, employment and socio-political organisation. Therefore, it becomes impossible to seek solutions to such deep-rooted problems without a structural analysis of the political economy of the third world countries. It is this structural focus on the African economy that could change the underlying structures that have been the major missing elements in part policies reforms. (World Bank, 1990 and 1994).

Therefore, the appropriate framework for such structural analysis should be grounded on examination of the enabling and disabling factors – internal and external, historical and contemporary - which have sustain underdevelopment in Africa. There are both static and dynamic factors at play ranging from the physical environment to socio-political influences as well as issues of policy strategy. World

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Bank, (1990) summarises Africa's problem to be that of "a vicious interaction between excruciating poverty and abysmally low level of productivity in an environment characterised by serious deficiencies in basic and social infrastructure, most especially the physical capital, research capabilities, technological know-how and human resources development that are indispensable to an integrated and dynamic economy."

It is based on the above observations that considerable attention has been cast on public enterprises in the last two decades, much of it centring on their poor performance and current global drift toward increase private participation alongside down-sizing of the public sector. Therefore, initiating public enterprise reform seems most appropriate or best available option for the government of the day and central bank of Nigeria reforms as a public institution forms part of these general reforms. However, initiating this reform is also a complex decision influenced by political and external environments, but the possibility, nature, pace and extent of public enterprise reforms depend to a greater extent on the motive or objective of the political leaders Campos and Esfahani, (1996).

Central bank of Nigeria is selected, as a public institution, for this study because of its role in economic development of the nation. Central bank of Nigeria (CBN) has played a major role in policy development and administration especially when economic policies are taken into consideration. Since its establishment in 1958, CBN has contributed in various dimensions to the development of Nigeria in

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general. However, the CBN is especially important in policy formulation, policy development and policy implementation since its creation. Its role in economic development stems from its being the apex monetary authority. It can therefore create and circulate money for development programmes – inflationary financing of development. Through the monetisation of the political economy of Nigeria, the CBN has made it possible to use monetary policies for economic stabilisation which entails controlling inflation to a level that warrants growth Nwankwo, (1987).

One major and very consistent activity of the CBN is its assessment of economic performance of the country in its yearly publication – Annual Report and Statement of Accounts. Although the publication has a section for evaluation of its activities and performance, few independent works has been done on the assessment of the performance of the CBN. Again, since its inception, CBN has undergone several structural and functional transformations but there is hardly any study analysing the effect of these reforms on the policy achievements of the CBN.

The CBN has been transformed from a centralised structure with two departments and seven (7) members of the Board of directors at inception to thirteen (13) board member organisation by 1978 after the first major financial sector reforms, to the present system with twenty – three (23) departments and one autonomous unit, to enable it cope with the increased scale, scope and complexity of its functions. Besides, given the expanse of the political economy of Nigeria, the CBN has decentralised its structure to having zonal offices, branches and currency

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centres as the case may be for easy and co-ordinated administration. There has also been a separation of the CBN workers from the unified public service salary structure since 1981 Onosode commission on federal parastatal.

The functions and activities of the CBN reflect the demands posed by the level of economic growth and development. The complexity and volume of economic and social activities have directly affected the CBN. The government has been very responsive to the public demands on the CBN by setting commissions to study its structure and functions. The structure and functions of the CBN were more stable during the period prior to 1980 than thereafter. This separation in period synchronises with the period of trade boom, which ended in 1979 and the depression beginning 1980. Since the depression especially during the period of Structural Adjustment Programme (SAP) the government has promulgated laws to enhance the functions of the bank in handling the changing economic problems generally and in particular, the problems in the banking and financial sector.

Following Phillips Commission Report on the Federal Civil Service, it was recommended that the CBN be moved to the Presidency for consistent and co-ordinated policy performance. The decree to that effect was promulgated in June 1991. This law has been regarded by CBN (1991) in its Annual Report as "a major land mark in the evolution of the CBN. Decree No. 24 which repealed the CBN Act, 1958 (as amended) considerably enlarge the power of the Bank in the execution of its primary duties, and its authority in this regard is only subject to that of the

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president of the Federal Republic of Nigeria." Banks and other financial Institutions Decree No. 25 of 1991 has also widened and strengthened the CBN's involvement in evolving a more stable monetary and credit system in particular and an efficient and sound financial system (CBN, 1991 Annual Report).

In the face of bank failure and financial distress which began in 1992 due to massive banking malpractice and speculation, the federal government promulgated the failed Bank (Recovery of Debts) and financial malpractice Decree No. 18 of 1994. This decree is also meant to empower and strengthen the CBN's capacity to monitor the banking and financial sector.

## 1.2 STATEMENT OF THE RESEARCH PROBLEM

Thus far, there are evidences that the organisational structure and functions of the CBN have been undergoing some changes. What cannot be inferred from these changes is the extent to which the changes have affected the CBN achievement. Against, this background therefore, the problem that this study is going to solve can be put across in the following research questions.

1. What are the major organisational/structural and functional changes that have taken place in the CBN since its inception?
2. To what extent have the organisational and functional changes in the CBN enhanced policy achievements in Nigeria?

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3. Has the redefinition of the CBN – government relationship (that is making the CBN to be responsible only to the presidency) reduced policy conflicts and enhanced the CBN's performance

## 1.3 RESEARCH OBJECTIVES

The fundamental aim of this study is to investigate the extent to which the changes in the structure and functions of the CBN have enhanced its performance and achievement especially in terms of policy performance in the Nigerian political economy. In order to achieve this global aim, the following specific objectives will be pursued.

1. To identify the changes in both the organisational structure and functions of CBN that have taken place since its inception.
2. To identify the relationships between CBN structural changes and policy achievement; and CBN functional changes and policy achievement.
3. To evaluate the implications of CBN – Government new relationship on CBN's performance and on minimisation of policy conflicts.
4. To assess the magnitude of changes in policy achievement that is due to structural and functional changes in the CBN.

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## 1.4 RESEARCH HYPOTHESES

To ease the investigation of the research questions and the achievement of the above objectives, the following hypotheses will be tested theoretically. The hypotheses here are stated in a null form.

1. Increase decentralisation of the CBN has not enhanced policy achievement in Nigeria.
2. There is no relationship between:
   (a) structural changes in CBN and policy achievement
   (b) changes in the functions of CBN and policy achievement.
3. There is no significant change in the magnitude of policy achievement due to the combine structural and functional changes in the CBN.
4. The CBN – government relationship does not affect
   (a) CBN performance, and
   (b) policy conflicts in Nigeria.

## 1.5 JUSTIFICATION FOR THE STUDY

CBN has been known to have contributed immensely to the formulation and implementation of government policies in Nigeria. It is also a very important public institution when considering the publication of public data and provision of information concerning the socio-economic changes especially when such changes are caused by the government and affect the lives of the people. The staff of the

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CBN (especially those in the Research Department) do publish researches bordering the policies initiated by the CBN however, independent researchers on the CBN performance as a public institution are few to come by. It is pertinent therefore to investigate the performance of the CBN as a public institution from an independent public standpoint.

Furthermore, the bank has relatively stable structure and functions from its creation up to 1980 when the economic depression started. Since then, there have been serious challenges of economic management to the CBN and the government. It became imperative to enlarge the functions of the CBN in order to enhance its policy achievements. However, there is no research that has been undertaken to find out the impacts/ effects of these structural and functional changes on the policy performance in Nigeria . There is need therefore to set about an independent study of this type.

Moreover, since this work will be an independent evaluation it will thus provide the CBN, government and the general public with an unbiased and reliable analysis of some aspects of the CBN's activities. They can thus use this work as a reference point and the finding of the work can be used for comparative purpose along with other studies especially those carried out by the government/ the CBN.

The government is particularly going to benefit a lot from this study because of the impact it will have on giving evidence about the realised effects of an aspect of reforms that have taken place, since inception. The research will therefore give

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information on past analysis and on the suitability and adaptability of the current structure of the CBN to assigned functions.

## 1.6 THE SCOPE OF THE STUDY

The study focuses on the various structural and functional reforms that have taken place in CBN since its inception. Much emphasis is given to the two major financial reforms, that is, the 1976/77 marking the oil boom and 1986 characterised by economic depression to suit policy demands on the functions of the CBN. Reference is also made to subsequent reforms after the 1986 (SAP). Generally, the study encompasses reforms and how these changes have affected the policy performance (outcomes) and autonomy of CBN in Nigeria.

Although the CBN is not the only policy institution in Nigeria, this study decides on the use of CBN alone because of the strategic importance and role of the CBN in the policy formulation and implementation and overall economic development of the nation. CBN is therefore adopted for study because it typifies policy institution.

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## 1.7 PLAN OF STUDY

Closely following this introductory chapter is chapter two, which deals with the review of relevant literatures. Chapter three provides an in-depth review of the CBN before the reforms. Chapter four presents CBN under the various reforms. In chapter five a study of CBN after the reforms is undertaken. It evaluates the effects/implications of these reforms on the CBN functional operations and autonomy. While Chapter six provides the Summary, Conclusion and Recommendations of the study.

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# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 INTRODUCTION

This chapter opens with a review of the literature on the political economy of crisis and reforms and then moves on to focus on the financial sector reforms. Specifically, the chapter is arranged into four sections. The next section gives a brief review of the Nigeria's political economic crises. This is followed by a survey of reforms and the last section reviews the financial sector reforms locating the central back reforms within it.

The third world countries, which are in crises, have many things in common: They are mostly post-colonial political economies; are major primary producers and exporters; they are poverty-ridden; they are in pervasive economic crises; they have political problems of military and civil dictatorship with liberal democracy being illusion; they are undergoing rapid social transformation; and they individually and jointly, constitute weak force and therefore cannot influence most international decisions. African countries are mostly identified with the characteristics thus outlined. Apart from those countries bounded by the Mediterranean sea in the north and the Republic of South Africa, the rest of African countries usually referred to as Africa, south of Sahara or sub- Saharan Africa, fit so much into the description

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above, Pickett, (1990). Besides, if the political features of the continent are to be described, the terrain is that of political backwardness and crisis.

The description above also suits the Nigerian political economy. Although the scope this study does not include any detailed study of such crises, for the purpose of deep understanding of the current reform programmes in Nigeria of which central back reforms are part, there is need to give a brief account of the Nigerian political-economic crises; and to show how this has culminated in the current reforms. The aim is to establish the theoretical basis for CBN reforms which is a response to the general economic and socio-political reforms that have been drawn out to stem the crises.

## 2.2 THE MORPHOLOGY OF POLITICAL ECONOMIC CRISES OF NIGERIA

The political economy of Nigeria has undergone superficial changes since independence but its structure as a primary producer remains. During the colonial era and in the first decade after independence, the country was a leading exporter of cocoa, groundnut, palm oil, and other agricultural produces. At the dawn of 1970s till date, Nigeria has been involved in the exportation of petroleum oil. The turn of fortune in the world market for agricultural produce in the 1960s was not so much a problem to the country because of the discovery of crude oil, which replaced

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agricultural exports with its (petroleum oil) price rising very rapidly in the early 1970s.

However, the crash in oil prices, which started in 1979, has been a major and immediate source of crises in Nigeria political economy (Iwayemi, 1995; Onimode, 1991). Since Nigeria depended on the oil export for her import financing and for her fiscal revenue, the fall in oil price meant that imports and government expenditures could no longer be funded. That led to cut in import, reduction in government expenditure and public debt problems Ekpo, (1990). This seems a light summary to the dialectics of world capitalism and its polarising effects on the world community, which have reduced the world into industrial and primary producing countries.

The present Nigerian socio-economic crises are rooted in the country's socio-economic relations with the western industrial economies. The present socio-economic relations started from the very foundation of the nation-state of Nigeria as a colonial agricultural input supplying economy to the imperialists metropolitan industries in the Western Europe particularly in Britain. In return, the Nigerian economy received manufactures from the industrial west. At independence the economy had been deeply but dangerously tied to the western market economies as a peripheral appendage of the capitalist west supplying primary commodities in return for manufactures, Polshikov, (1981).

It is even more important to note that whereas the western theory of trade base on comparative advantage emphasises the third world production of and trade

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in primary commodities while importing manufactures from the industrialised west, the terms of trade (ratio of price export to price of import) are always in favour of the manufactures, Sapsford, (1990). The reasons for which the price changes in manufactures are always more favourable vary from the large size of market, high durability of products, high level of response to increase in demanders' income; unto the politics of price determination in which the west has the political and economic power to dictate both the price of its products and the price of the raw materials, that is, primary products from the third world, Sapsford, (1990), Onimode, (1990), Ekpo, (1990). These authors observe that it is these political economic relations that led to the importation of crises into the Nigerian economy in the following ways: first, the price of oil has been forced down from the second half of 1970; second, the import prices have been rising rapidly; third, regressive contract terms between Nigeria and the western economic partners in lending and professional fees. Again, as Fadahunsi, (1992) observed the politicisation of activities relating to technology transfer ensures that the industrial pursuits of the country are illusion.

Perhaps, it is also necessary to bring on record that the social life-style of the west-trained Nigerians has only aggravated and deepened the country's economic relations with the west by encouraging mass importation of western products to satisfy their consumption. Apart from increasing import bills, this mass importation has been a major reason for the fall in agricultural production at the ensuing of the crisis, Onimode (1991). Given the continued fall in the price and quantity of imports,

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the options, were to continue running the economy on deficits (the devil's option!), or to carry out some reforms and Nigeria settled for the latter.

The major characteristics/results of the crises in the political economy of Nigeria were rapid fall in government revenue, a fall in domestic production in other sectors due to lack of imported inputs, rising foreign and domestic debts, rising unemployment, and complicated social problem of robbery and other crimes caused by rapid urbanisation and high taste for modernity, Ndebbio and Ekpo, (1991).

These problems along with corrupt civil leadership are even compounded by the political instability of the nation. Immediately after independence, the country has been subjected to lots of incessant coup d'etat. The coupists always come with the sole excuse of correcting the prevalence crises perpetuated by their predecessors. This was how by 1985 the country ushered in the government of General Ibrahim Babangida, who in 1986 embarked on a comprehensive structural Adjustment Programme [SAP}. It should be said here that prior to the 1986 reforms christened SAP, other governments - Obasanjo 1975-79, Shagari 1979-83 and Buhari 1983-85- have embarked on some stop-gap, ad hoc measures to address the crises with very limited success because they saw the crises from economic view point, or worse still as sectoral crises.

The structural Adjustment Programme (SAP) as implemented in Nigeria according to Okunrounmu, (1993) has the following objectives and policy strategies.

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(a) To restructure and diversify the productive base of the economy in order to reduce dependence on the oil sector and on imports;

(b) Achieve fiscal and balance of payments viability over the period;

(c) Lessen the dominance of unproductive investments in the public sector, improve the sector's efficiency and intensify the growth potential of the private sector;

(d) Lay the basis for a sustainable non-inflationary or minimum inflationary growth.

Strategies for the implementation of SAP include:

(a) The adoption of a realistic exchange rate policy coupled with the liberalisation of external trade and payment system;

(b) Adoption of appropriate pricing policies in all sectors with greater reliance on market forces and reduction in complex administrative control;

(c) Further rationalisation and restructuring of public expenditures.

It is based on (c) and (d) of the objectives and all the policy strategies stated above that the financial sector reform is located as a necessity.

## 2.3 DIMENSION OF REFORMS

There are various schools of thought regarding the coverage, timing, sequencing of and commitments to reforms. Chang, (1992) on considering the issue in public enterprise (PE) reform noted that it is wrong to consider reform as purely

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economic issue. While addressing issues on public enterprise (PE) reforms he reckoned that,

> If the establishment and the operation of PEs for what ever reason, constitute an integral part of clientelist politics, it becomes difficult of expect the improvement of PE performance through 'policy' solutions ... Economic problems, in order words, are never completely technical in the sense that they are "politics – free", and are question of political economy. Thus seen, in many LDCs an improvement in PE performance would not be forthcoming, simply through formulae but require a political reform with a view to nation building.

Fundamentally, therefore, issues of reforms have political dimension since the decision – making process to carry out reform of any type and the execution of such policy is a political process.

Crises and the associated reforms are even considered in a wider perspective by Economic Commission for Africa (ECA, 1990) who regard production activities as social activities and the crises as such are social crises and by extension the reforms necessary to bring about any change must be socio-economic and political. "The significant elements of the socio-political setting for Africa's political economy consist of the social organisation, the political system, institutional set-up, management of the economy and the cultural milieu. These factors interact with the production structure of the economy to determine the dynamism and relative viability of the development process," ECA (1990). Similarly they also regard the social setting as consisting of the social organisation of production, its associated

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pattern of ownership and distribution, forms of social differentiation and cultural milieu, emphasising that the core of this setting is the social organisation of production.

ECA thus reject the narrow conception of production as economic process of production and reproduction but broadly regarded the process as a social system in terms of relationship among groups and individuals. With this regard, the need for reforms of the African social system is clearly justified and well juxtaposed within the context of the general reforms. If the economic reforms, which emphasis reforms of production process, economic relations (ownership, employment, wage, and pricing processes), and government policy reforms must be successful there is need to look (beyond economic relation) into the social relations matrices in which the economy, or better still the political economy is situated.

The perceptions of ECA (1990) also shared by Mamdani et al, (1988) on socio-economic problems and reform are remarkably different from the World Bank group. For while the latter see the problem and therefore the reforms as economic with minor political adjustments, the former regard African crises and the required reforms as socio-economic.

Emphasis on socio-political reforms becomes eminent in a country like Nigeria where ethnicity, tribal politics, and dictatorial military administration have entrenched serious crises of confidence in the body polity of Nigeria. The success of any reform in Nigeria requires riding the political economy of corrupt practices

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which can easily frustrate reform objectives. This, of course calls for reforming the social systems of the political economy through appropriate education and information media. The social issue also becomes very crucial when tracing the causes of financial distress and when thinking out the solutions for this problem in Nigeria.

While outlining the causes of bank failure in Nigeria, Ebhodaghe, (1995) noted unfaithful management staff, boardroom quarrels and insider activities in lending process as some of the pernicious problems that has distressed the banking system in Nigeria. The insider lending frauds has also been emphasised somewhere else, Ebhodaghe (1995), as a major cause of banking failure in Nigeria. These are really social problems that have to do with manager's and workers conception about the funds in the banking system. Any reforms contemplated of the banking system that do not account for these social aberrations may end up as an addition to paper work and leave the problems in the system unresolved.

Apart from a sound moral education system, the social reform can also be affected through a sound legal system. Socio-economic reforms can only succeed in a conducive legal system. In general, reforms lead to increase private participation and increased transactions and business within the political economy. This also increases the possibility of fraudulent activities. The judicial process should be responsive to change and to make laws that would govern the socio-economic processes. "The objective of this effort is to establish, visibly, a rule – based

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economic system in which the rule governing economic activity are generally available and understood by the population. Those rules are to be enforced uniformly and universally with stable, predictable pattern over time. And they are to be change through transparent means." World Bank, (1995)

In order for these transparent processes of law making and execution to be guaranteed, there is need to have a legitimate government in the course of the reforms. It is not quite certain as to the type of government that will be most successful in carrying out a wide range socio-economic reforms. Studies have tended the support the fact that benevolent authoritarianism combined with political stability is expedient for success of wide reform programme. "Benevolent authoritarian regimes (led by philosopher despots) were needed, it was argued, to push through unpopular reforms and tame and unruly or otherwise ineffective administration". World Bank, (1992). The World Bank believed also, while noting the current waves of democracy that started in the 1980s, that democracy could make reform more feasible in several ways including political checks and balances, free press, open debates on the costs and benefits of government policy.

However, there is no hard and fast conclusion concerning which type of government can push through reform programmes more successfully. What is more certain is that after the reforms democracy is necessary for the thriving of the market oriented, laissez – faire economy ushered in by the reforms.

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World Bank (1992) opined that the scope of the economic reforms that are needed in the developing world varies widely depending on the level of crises in the economics. Thus while some countries need to rationalise prices and incentives; others need to privatise state-owned enterprises or invest in education, health and infrastructure. It has been observed that reform programmes in every country have always generated some social problems and political conflicts due to the class trade – off between the gains and losses from the policies of reform. Thus, reform policies must also develop ways of dealing with socio-political conflicts and trade-offs arising from reform programmes, (World Bank 1992, ECA 1991, Campos and Esfahani 1996).

In considering the scope of reforms there are basic ingredients that must be taken into account. There is no historical antecedence, however, that suggests the order and timing of reform. Nevertheless, there are some general principles even though there are only few hard rules to be followed. These principles focus on the process by which the objectives of the reform policies will be achieved at minimum social costs and relatively low political tension and conflicts. The factors that form the principles of good reform programme must be accepted by the targeted policy group as being credible. The credibility of the reform policies can be enhanced by the political relations, image, and legitimacy of the government that is initiating the reforms. If the policies of reform lack credibility, as the World Bank (1990) observes, a vicious circle of policy – responses may be set up by the policy target

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group which will negate the reform objectives. Another principle which requires careful management is that of maintaining macro-economic stability, that is, ensuring that inflation is well contained so that prices do not rise beyond the common-man's endurance. This has to do with managing prices of goods, interest rate, exchange rate and commodity taxes World Bank (1992). There is also the need for policy flexibility so as to contain the vulnerable group during the period of reform (ECA 1991).

Another crucial factor includes the timing of the reform. This involves political considerations. It requires strong political will power. New government, which does not have any heap of political criticisms, stands in a vintage position to undertake reforms. Again, economic and political crises offer the opportunities for initiation programmes of radical changes, Galal (1991), World Bank. (1992). Very closely related to the timing of reform programmes are the speed and sequencing of such programmes. With respect to the speed of reform, the socio-political environment will again be the determinant factors of speed besides the nature of the reform programme. In fact (United Nations 1984) sum it thus:

> Some problems can be solved more quickly than others, but all of them deserve priority attention by government bent upon recovery and development... The goal of reform must be accepted and that the journey towards it must begin in a systematic way, bearing in mind the needs in the interrelated areas of money, finance and trade.

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While price reforms can be done quickly because of its nature, for the same reason institutional reforms such as commercial/contract law reforms do take longer time to develop in which case gradualism works better.

Sequencing of reforms actually is a principle that supports the interlocking and interrelated nature of reform policies, that reforms of one sector/system necessarily require the consequential reforms of others. The issue however is which sectors, systems, and institutions should be reformed first and which should follow. The answer to this question require a sound understanding of the likely effects of every policy such that the unwanted effects of some reforms may be offset by the good effects of another set of reforms. World Bank (1995). For instance, unemployment may be generated from rationalisation and privatisation of public enterprise but employment may be generated from the deregulation of the financial sector. Thus that two processes – public enterprise reforms and deregulation of the financial sector can go hand in hand. Sequencing of reform programmes also demand good political relations and understanding.

Restructuring the political structures along with the general reforms for efficiency has informed the concept of decentralisation as a political measure for administrative purposes. Rondinelli, et al (1984) in their opinion submit that "decentralisation will reduce overload and congestion in the channels of administrative and communication thus reducing administrative delays." It is also assumed that decentralisation will improve government's responsiveness to the

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public and also increase the overall outputs of services provided through the independence of the different arms of the polity. Thus, as an aspect of political reforms, it is justified as a way of managing national economic development more effectively through private sector and grassroots participation in development decision-making and economic production.

Besides, the structure of Africa's political economy demonstrate why policy reforms aimed merely at improvements of financial system and price structure hardly succeed in bringing about economic transformation and sustained development. Positive actions are therefore needed to redress the structural bottlenecks and imbalance in the fabric of the entire political economy. United Nations (1984) summaries the underdevelopment of African states thus "Africa's crisis is a compound problem thus, it would be a mistake to see Africa's problems as merely the result of weaknesses of development policy." This portrays the importance of reforming the entire system as a panacea for African's crises.

In demonstration to the (UN, 1984) suggestion of reforming the entire political economy, developed nations both jointly and severally are calling for democratisation of all sovereign states of the world, believing that a free market economy or socio-economic development could only be attainable in a democratic states. This establishes the crises of political instability in many African states, which is an index of measuring underdevelopment. Okunade (1992), observed that it is the political instability of African states that has called for democratisation as a

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categorical imperative for all countries by the global agenda. This bring to focus in international politics the primacy of democracy and human rights as a twin dominant for development. As a result democracy has become a universal concept and all civilised countries of the world have acknowledged this principle as a socio-political reforms required for the growth and development of any society Diamond, (1992), Haggard and Webb (1993).

Also, Mamdani, et al (1988) in his socio-political transformation of African's analysis and Rostow (1960) economic restructuring maintained this position for a societal transformation through democratisation for societal development. Thus democracy is viewed as a socio-political reform and economic reform and development could only be guaranteed in a democratic political system.

Therefore, the problems encountered in reforms efforts in the less developed countries, which stem from the low level of their development, include inflexibility of policies of reforms, policy inconsistency, negligence of the vulnerable group, lack of policy experts and other professionals, political instability, lack of transparency of policy operators and political leaders, lack of data, lack of information, non-supportive social institutions and weak and unresponsive legal system.

## 2.4 FINANCIAL SECTOR REFORMS

Financial sector is crucial to the development of any economy. As already noted in other sections above the slow growth of the sector is fundamentally due to



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the underdevelopment of African Countries and their inability to attract more foreign capital. Over the last decade, financial system in Africa has undergone substantial changes in terms of number and variety of financial intermediaries, and instruments in the money and capital markets. Despite these changes, the financial system still remains relatively underdeveloped as it has not yet acquire the degree of financial deepening required by the economy for rapid development.

The structure of the financial system consists of bank and non-bank institutions, instruments and markets. The financial institutions range from moneylenders to banks, pension funds, insurance companies, brokerage houses, investment trusts, finance companies and stock exchanges. Financial instruments include: Coins, currency notes and cheques, mortgages, corporate bills, bonds, and stocks while markets for these instruments are usually grouped into money and capital markets depending on the maturity of the instruments, Omoruyi, (1991). Therefore the trace of underdevelopment arouse a need to reform the structure of the financial system.

Financial sector reform is part of the political economic reforms. Ndung'u (1997), defines financial sector reforms as "a process through which interest rates are deregulated, a variety of regulations on the financial sector and in the economy are changed, bank supervision is made more effective, there are legal and judicial reforms, there are efforts to build a financial infrastructure, and there is an effort to change the incentive structure that faces intermediaries, borrowers and depositors".

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By this operational definition of financial sector reforms, the activity-mix in the process of the reforms is made part of the reforms of the political economy as a whole as well as the reforms of the legal system. The reforms of the banking supervision and monetary regulations processes (which involves the central bank reforms) are thus only part of the general process of the political economy.

According to Omoruyi (1991), the introduction of financial sector reforms in order to correct the distortions and rigidities in the system was to achieve the following objectives:

(a) improvement in the efficiency in resource allocation through greater reliance on market forces;

(b) greater mobilisation of domestic savings for investment and growth through market-based interest rates;

(c) improvement in regulatory procedures;

(d) promotion of greater competition in the provision of banking services;

(e) laying the basis for a sustainable non-inflationary or minimal inflationary growth.

The achievement of these objectives also depends on the policy instrument adopted for the reforms.

However, for the financial reforms to be successful, Ndung'u (1997) observed, the central bank need to be well disposed to control and monitor the banking and non-financial units of the financial system so as to keep down the rate

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of inflation which may result from excessive monetary expansion. Here the need for timely and accurate information availability to the central bank is emphasised. Ndung'u, Falegan (1986) also pointed out that there is need for efficient money and market situation, for indirect control of the financial sector to be effective, but such efficiency and control significantly, improve as the financial sector develops. This is making a case that the reforms in the financial sector or any part thereof require that other sectors of the political economy are reformed and also the supporting environments are adjusted to the new reins of activities.

Ndung'u further observed that it is important to have appropriate sequencing of financial reforms if reasonable success is to be attained. The same idea is shared by Soyibo (1997). They both agreed, basing their sequencing on financial sector reforms on Montiel (1995) as follows:

(a) Restore macroeconomic balance, together with restructuring or liquidating ailing financial institutions.

(b) Introduce indirect monetary instruments with freely determined interest rates, together with establishing supervisory capacity of the central bank on the financial system

(c) Encourage competition in the banking sector by encouraging more domestic and foreign banks and reducing government shareholding in the financial sector

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(d) Liberalise interest rates and remove all forms of administrative controls on the financial sector. (Ndung'u 1997; also Soyibo, 1997 states similar process).

Thus sequencing again converges on the fact that the success of the sector reforms require reforms of the entire economy and the reforms of the central bank to regulate the resulting activities in the financial system.

Restructuring the financial sector as African Development Bank (ADB, 1997) highlighted involves strengthening the regulations and supervisory capacity of the banking system, strengthening the legal framework, restructuring the banking system and enlarging the scope of capital markets. The supervisory and regulatory capacity of the banking system rest to a large extent on the central bank of any country. To facilitate the supervision and regulation of the system ADB listed five measures:

(a) Limits and constraints on banks such as lending limits and liquidity ratios to ensure the safety and soundness of the system;

(b) Guidelines to restrict lending to insiders management or bank staff or to connected parties'

(c) Specific and clear criteria for screening owners and managers of new banks;

(d) Capital adequacy guideline … as well as restrictions on dividends when the banks is incurring losses; and

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(e) Guideline specifying the extent of asset diversification or limit of exposure concentration.

The specifications are mostly the measures to enhance the performance of the central bank in any financial system.

ADB, (1997) emphasising the need for legal system reforms to strengthen the financial sector noted that "another important area for making improvement in the banking infrastructure is the legal framework of the banking system, as well as debt recovery and bankruptcy laws. The body of a nations commercial laws governing contractual relationship between entities including banks". The reforms of the financial system in which central bank reforms are part therefore require a favourable legal system to thrive. This view is also expressed by Cukierman et al (1992). As ADB (1997) further observed, there are many African countries where by the laws relating to debt recovery are more hostile to the lender, thus placing the banking system in a strait of disincentives. Again, the legal process is often cumbersome and dispensation of justice is long-drawn for years in most countries. This has formed a source of discouragement to banks in their debt recovery drive and ultimately has made a strong case for bank failure in a country like Nigeria. World Bank (1995) also maintains similar position about the relationship between economic and legal reforms.

Reform of the banking system also require a strong easily accessible and easily interpretable information system Soyibo, (1997). In agreement ADB (1997)

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points out that "strengthening the banking information system, along with the accounting and auditing frame work, can facilitate the improvement of banking infrastructure". It should be reiterated that smooth information system is a basic necessity if the apex bank should be able to protect weak banks from bankruptcy and failure Zhen et al, (1982). This, of course, calls for a legal backing and enforcement of such practice. The success of any accounting standard practices however depends on the availability of professionals in the banking profession. The situation in Nigeria is increasingly improving in terms of professionalisation of banking and accounting practices in the banking system.

Indeed Soyibo, (1997) claimed that "banking reforms assigned a greater role to the market in the allocation of resources particularly on areas of more efficient and productive use. Accordingly reform is expected to improve the incentive for depositors to save by ensuring that deposit interest rates are positive in real terms". The expectation is that credits will be made more available to fund users. The funds so borrowed are expected to be channelled to productive investment, thus generating employment and greater output in the economy.

The irony of the financial sector reform implies the restructuring of the banking system from the root of the sub-sector, which is the ownership. The government must withdraw from the direct investment in the banking activities except for the central bank, banking system should be opened to competition and all activities should be carried out with the aim of making profit and surviving in the

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banking business. The ownership structure that can thus enhance efficiency is private ownership. The withdrawal of the government from banking ownership is very crucial if the aim of the government to reduce deficit financing and its inflationary effects must attain any level of realisation. For the gains of the restructuring to be sustained, there is also need to encourage diversified banking-commercial, merchant, development and household savings-oriented bank (ADB, 1997). This has the advantage of increasing the monetisation of the political economy which will then form the basis for sustainable business opportunities while providing intrasectoral linkage.

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# CHAPTER THREE

# PRE-REFORM CENTRAL BANK OF NIGERIA

## 3.1 HISTORICAL BACKGROUND TO THE ESTABLISHMENT OF CBN

Ndekwu (1990) has grouped the argument for the establishment of the CBN into three schools of thought. These schools are classified using historical backgrounds to establishment of some central banks and the economic and political demands that led to the formation of others. According to Ndekwu the three schools are: the evolutionary, the functional, and the developmental arguments for establishment of the central bank.

The evolutionalists are mostly the European monetarists who, given the circumstances in which the Bank of England evolved from an ordinary commercial bank to a clearing house and later to currency issuing authority, believed that the establishment of any central bank should be preceded by a well developed financial structures, and that the need for a central bank should exclusively be based on exigent needs in the financial system. Basing their argument on this evolutionary process the colonial authority, speaking through Fisher and Loynes, believed (Perhaps innocently) that it would be inadvisable to contemplate the establishment of a Central Bank in Nigeria even in the 1950s. The major strand of their argument against the establishment of the Central Bank was underdeveloped financial system.

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This argument was negated and expunged by the Nigerian nationalist who believed in the Central Bank as instrument of development of the financial sector and the economy as a whole.

According to Ndekwu (1990), the functional thoughts to establishment of the central bank are based on the reasoning that as long as there exists an economy which carries alongside the existence of a financial system, then there exists the need for a central bank, so as to execute the functions of regulating and servicing the system. What Ndekwu did not say, however, is that the establishment of central bank is a necessity for the political autonomy of the country. Thus, one systemic reasoning for independence of the financial system of one country from those of others is so that the political economy may have and sustain its sovereignty. The functional arguments were among the important ones presented by Nigerian while calling for establishment of the central bank of Nigeria.

The developmental reasons somehow provided the most recourse to the demand for a central bank in Nigeria. As a Colonial peripheral nation-state, Nigeria needed many socio-political and economic structures prior to the political independence to enhance her development. Thus, it was argued that if the financial system and the economy must be developed, then, a central bank had to be established. Just as the functional reasons, developmental arguments for the establishment of the central bank, has a lot of political undertone since the development of any part of a nation-state must intend to extol the existence,

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sovereignty and independence of the nation-state. After all, no call can be made to the development of a non-existing state or political economy.

In the presentation that follows, the historical events and arguments leading to the formation of the central bank of Nigeria are reviewed. Nonetheless, there is no compartmentality between the functional and developmental thoughts in the arguments presented by the Nigerian nationalists demanding the establishment of a central bank in Nigeria. But there appears a clear reliance on the evolutionary argument by the British Colonialists against which background they were opposed to the establishment of a central bank in Nigeria.

The development of central banking in Nigeria could be traced to the characteristics and deficiencies of the British Colonial monetary system, which preceded it. Under this system, the currency or legal tender obtained in the Colonies was issued by a currency board and in the case of West Africa, the issuing authority vested on the West African currency Board (WACB).

Following the recommendations of Lord Emmort committee of 1910 the WACB was established in November 1912. The basic problem that had to be addressed by this board was the eradication of the confused and unsatisfactory currency situation in British West Africa, and also the discovery of the best method of financing the needs of the export trade of the expatriate firms in West Africa. As opined by Nwankwo, (1987), the regulation governing the duties of the Board as stipulated in the Colonial office memorandum were designed to achieve three main

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objectives which include: first, issuing a West African currency, second, ensuring a speedy convertibility of this currency with the old silver currency, and lastly to provide a means whereby the Colonial governments might share in the profits of the currency issue. Therefore, the WACB was to execute four main functions: the issue of a West African currency, its exchange for existing currencies; the repatriation of existing currencies; and the investment of its reserves.

In effect, these functions were religiously discharged by the WACB though in the process, it was characterised by three elements: namely fixed parity of local currency with sterling; automatic issues; and 100 per cent sterling coverage. Fisher (1956) in Nwankwo (1987) advances the benefits of the system thus, the 100 per cent sterling coverage would ensure the exchange stability of the West African currency in term of sterling, while the automatic link with the sterling ensured that in times of financial stress British West African Colonies could look to London for help. According to Fisher, in effect, London acted "as the international money market for Nigeria ... and confidence in the currency was maintained". Another British expert, Loynes, also shared this view.

However, the affirmation by Loynes was not without some defects such as the dependency of the currency unit issued by WACB and its automatic link also implied the dependency of Nigerian currency on the British pound thus lacking credibility of monetary control and power to initiate and execute monetary policy. Again, based on the concentrated investment of WACB reserves in sterling overseas in London, local investment outlets were not developed. As a result money and capital markets were absence in the country and this had serious consequences for the Nigerian economy (CBN, 1979).

According to (CBN, 1979) as a result of the above deficiencies of the WACB, the vision for the establishment of an institution in the form of central bank by nationalist leaders became intensified and inevitable. After lots of controversies on the establishment of a central bank for the purpose of rapid development, the Colonial administration appointed Mr. Fisher of the Bank of England to inquire into "the desirability and practicability of establishing a central bank in Nigeria as an instrument for promoting the economic development of the country".

Fisher's report was not palatable to Nigerian nationalist leaders but rather stimulated them more for their demand because the bank to them was a prime instrument for economic development. Fisher's argument centred on the underdeveloped financial structure of the system, but while still reporting, a World Bank mission visited Nigeria in 1953 and also examined the contesting factor of establishing a central bank in Nigeria. Though it agreed with Fisher's analysis of Nigeria's financial constrained to operate a Central Bank; the mission rather recommended an early creation of a state Bank of Nigeria with limited functions to expedite the progress of Nigeria towards independence which was more important and did not warrant the rather too cautious timing implied by Fisher.

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Nevertheless, the Federal Government with the achievement of internal autonomy in 1957 engaged the services of Loynes also of the Bank of England, to make recommendations on "the establishment of a Nigerian Central Bank, the introduction of a Nigerian currency and other associated matter". Loynes Report 1957 in Nwankwo (1987).

Finally, Loynes's recommendation culminated in the establishment of the Central Bank of Nigeria in 1958 by the central bank ordinance of that year. The CBN effectively came into existence and commenced operations on 1 July 1958.

In summary, from the available literature, it could be concluded that in the evolution and establishment of central banks, it is politics, nationalism along with economics that have usually been the major determinants. This was evident in the establishment of the mother of central banks, the Bank of England, and also evident in the history of the central banking in the United States. So in Africa, as in all continents central banking were demanded by nationalism as a brake on the monopoly power of commercial and expatriate banks, as an escape from the domination of foreign money markets and from the rigidities and automatism of the currency board monetary system.

Again, the chronicle of events in the time by which the establishment of CBN was contemplated is also very relevant in adducing the principal reasons for its establishment. The decade 1950s marked the crescendo of the political struggle for independence. There was increased indigenous control of the political machinery

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and the constitutional development had made some distant stride. Most of the demands on the colonial authority to establish some socio-economic structures must not be interpreted in term of economic or sociological need however pressing and appealing such reasons may look. As conceded by Ajayi and Ojo (1981)

> ...The most noticeable argument in favour of a central bank in less developed countries is political. Most of the countries see the establishment of a central bank as an outward and visible sign of independence and the lack of one as evidence of continued political subjection.

Therefore, the political pressure of the time should at least be mentioned even as an aside factor. So in the establishment of the CBN, it is hereby contended that the demand was part of the whole political struggle and pressure for independence.

It is however pertinent to observe two contrasting position in the British argument for the establishment of WACB as compared to the establishment of the CBN. Given the fact that the WACB was aimed at mere monetisation of economic transactions in the British West Africa, exploitation of economic potentials of those colonies would have been facilitated. Therefore, WACB could be seen as an empirical monetary structure set up to advance the interest of the imperialists in Britain. Furthermore, whether in the short-run or in the long-run, there was no anticipation that the WACB as an institution can enhance or cause any anti-colonial struggle – its establishment never posed any threat to the colonial authority and there was no critical opposition whatsoever.

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On the contrary, CBN establishment was not thought out as a mere currency issuing authority. Its functions had so much to financial and economic autonomy of Nigeria. Hence the agitation for the creation of the CBN might have been seen by the British authority as an aspect of the total struggle for political independence, a threat to the political and economic interests and exploitation of the British Colonial control. This suspicion, it can be reasoned, was what formed the veil behind which British economists and bankers hid to argue against the establishment of the CBN. The opposition by British authority at the inception to the establishment of the CBN can therefore be assess in terms of the content of political fears in their minds which thus form the political-economic argument. However, from the nationalists' view point the fears in the minds of imperialists were founded when sized against the real political aim of the establishment of the CBN (which was to fortify the autonomy of the political economy of Nigeria).

## 3.2 EARLY ROLES AND FUNCTIONS OF THE CBN

At the inception of a central bank as demonstrated by the mother of all central banks, the Bank of England, the central bank was meant to performed three traditional roles namely: managing the nations monetary system, serving as a banker to commercial banks, and acting as a financial agent for the national government Ajayi and Ojo (1981).

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Of the above functions, the most important of them is its control over the monetary system. In an attempt to achieve this responsibility saddle upon it, the central bank regulates the supply, cost and availability of credit. The excellent performance of the central bank to control the monetary system is enhanced by the central Bank's ability to create and destroy monetary reserves through its lending and investing activities. Thus it is the ultimate source of cash and its liability is the base on which commercial banks form their credit-creating policy.

As a banker to commercial banks, it provides those essential services to the banking system similar to those performed by commercial banking system for individuals and business enterprises. These services include holding the legal reserves, acting as a lender of last resort and providing services that will provide the smooth working of the monetary system which include clearing and collection of cheques, distribution of coins and paper currency to commercial banks (CBN 1979).

In performing the role of a financial agent the central bank acts as the banker to the government. It receives, holds, transfers and disburses the funds of the government and also provides technical services relating to the public debt and financial advice to the government.

In the Nigerian case the traditional functions performed by the CBN according to Ajayi and Ojo (1981) could be itemised as follows:

(a) Issuing legal tender currency;

(b) Acting as banker and financial adviser to the federal government;

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(c) Promoting monetary stability and a sound financial structure in Nigeria; and

(d) Maintaining external reserves in order to safe guard the international value of the currency.

To them these functions could easily be classified into two broad categories, that is, the service functions and the policy-making function. Nwankwo (1987) also have a similar classification of the functions of CBN. Service functions include items (a) and (b), while policy – making functions include items (c) and (d) above.

Issue of legal tender currency as a service function – through the authority vested on the CBN, it is the only bank of issue in the country. This role was first performed on 1 July 1959 when the bank issued the first national currency and with the issue of that currency, the West African currency Board notes and coins were withdrawn from circulation. This first notes and coins issued by the CBN were later changed in 1968 due to the prevailing conditions of the civil war. Then in 1973 the decimal currency which is currently in circulation was introduced to measure up with the monetary standards world over.

In performing the service function of Banker and Adviser to the Government, the CBN from birth has been in charge of the banking business of the government. It holds the treasury bills and treasury certificates for all government through long term securities, CBN, (1979). As a financial adviser to the government, it seeks to ensure co-ordination between government's financial policy and the main national economic objectives of growth with the framework of monetary stability. This is

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often done through the Bank's monetary proposals during the preparation of Annual Budget and various other ways. The CBN also regulate the banking system through its banking legislation, examination and supervision which all geared toward the eradication of malpractices and improving the banking system Ogunleye, (1995).

As earlier noted, the policy-making functions of CBN include monetary and Exchange rate policies. In areas of monetary policy, the central Bank has the responsibility of formulating and executing monetary policy using discount rate, the liquidity ratio or reserve requirements, moral suasion, open market operations and selective credit control as its main tools. Also, in executing the exchange rate policy it is the duty of the central Bank to maintain external reserves in order to safeguard the international value of the currency. To this effect, the bank becomes the custodian and manager of the country's gold and foreign exchange reserves, CBN, (1979). All these functions are in pursuance of its role as an engine of development.

However, as already mentioned, the agitation for the establishment of central Bank in Nigeria was based on the functional and development schools, although in the establishment the development roles were not spelled out in its statutory objectives but that does not mean they were not implied. This role was subsumed in its traditional function of promoting monetary stability. This is because the promotion of monetary stability and sound financial structure implies economic development Nwankwo, (1987). Ajayi and Ojo (1981) also share this opinion when they argued that the only meaningful role that can be assigned to a central bank in a

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developing country is developmental. That the central bank can be called upon to develop the financial structure necessary for it to perform its traditional roles in the future. They forge ahead to cite an example, of Nigeria's central Bank which has aided and nurtured the development of the money and capital markets and also through its regulatory activities has helped to developed a sound commercial banking policy.

This developmental roles have been illustrated in the six budget speeches of the then minister of finance, late Chief Festus Sam Okotie Eboh, when he keeps emphasising the developmental role of the Bank specifically in the mobilisation Budget in 1962, he clearly stated that "the basic objective of all monetary and financial policies must at all times be directed to facilitate the economic development desired" Nwankwo, (1987).

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## 3.3 THE ORGANISATIONAL STRUCTURE AND CHANNNEL OF RESPONSIBILITY

At its inception, the organisational structure of CBN was very modest, consisting of two departments; that is, the General manager's and Secretary's departments with appropriate division of labour. The management of the Bank is placed under the Board of Directors which is "responsible for the policy and general administration of the affairs and business of the Bank" CBN (1979). Originally, the board of Directors consisted of seven members – the Governor of the bank who was the chairman, a deputy Governor and five other directors, who were all appointed by the federal government. The governor and deputy governor were appointed for five years while other directors were appointed for three years. However all board members were eligible for re-appointment.

The appointment of members of the board of directors by the federal government establishes a fundamental link between the bank and the government of the day even though the terms of office of the board members do not depend on the life span of any government. Under this arrangement, the board is the engine – room of the bank because of its sole responsibility as a policy-making organ of the bank. Nevertheless, these policies are subject to approval by the federal executive council. On the other hand, this approval does not make the central bank an appendage of a federal ministry rather an autonomous public institution established by an Act of parliament whose power and functions are derived from the Act.

As observed by Ndekwu, (1990), the CBN cannot be divorced from the federal government due to its nature and character which include: being wholly a federal government enterprise and in fact, the most efficient and productive of all public enterprises in Nigeria; its decision-making organ being appointed by the federal executive council; and the Bank's policies being subjected to approval of the federal executive council in order to ensure the consistency of the bank's policies with those of the federal Government. However, CBN (1979) ascertained that in the exercise of its responsibility, the board is authorised to exert rules, relations and

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instructions within the framework of the CBN Act in order to facilitate the efficient execution of its functions. Before 1970, there also existed the advisory committee which was a statutory committee of the bank. It was charged with the function of providing a direct link between the bank and the governments' functionaries that are responsible for finance and to make the geo-political structure of the country bear some relation with the banks.

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# CHAPTER FOUR

# CENTRAL BANK OF NIGERIA REFORMS

## 4.I INTRODUCTION

This chapter is divided into four sections. Briefly following the introduction is section two, which proffer justification for the CBN reforms. Section three evaluates the re-organisation of CBN while section four deals with the reforms and autonomy of CBN.

Central Bank of Nigeria is a public institution owned by the federal government of Nigeria. As an organisation it is subject to the dynamics of organisation restructuring over a period of time. Attempt to finding solutions to organisation problems through a more effective and efficient management usually result in an improved organisational structure which is what French and Bell called organisational development and is attainable through the introduction of a change agent – (motivator, innovator or transformation).

Indication by economic history shows that no nation has ever developed without an appreciable growth in the financial sector. Both the financial sector and the real sector of the economy are interwoven. Developments in the real sector influence the speed of growth of the financial sector directly while the growth of finance; money and financial institutions expedite growth in the real sector. This

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implies that a financial system enhances economic development through improvement in efficiency brought about by the provision of a means of payment, payment system and various other means. Yet, for the growth of a financial sector, an apex institution which is a central bank plays a vital role Ajayi, (1995).

As a sub sector in the economy, CBN has been responding to developmental changes of expanding economic activities in the political economy. Therefore, restructuring of CBN organisational structure and functions is a necessity for it to achieve its monetary policy objectives to bring about the desired economic growth and development. An illustration of the central back of Nigeria's relationships with the economy and the socio-political system, which necessitate the reforms, is provided in fig. 1.

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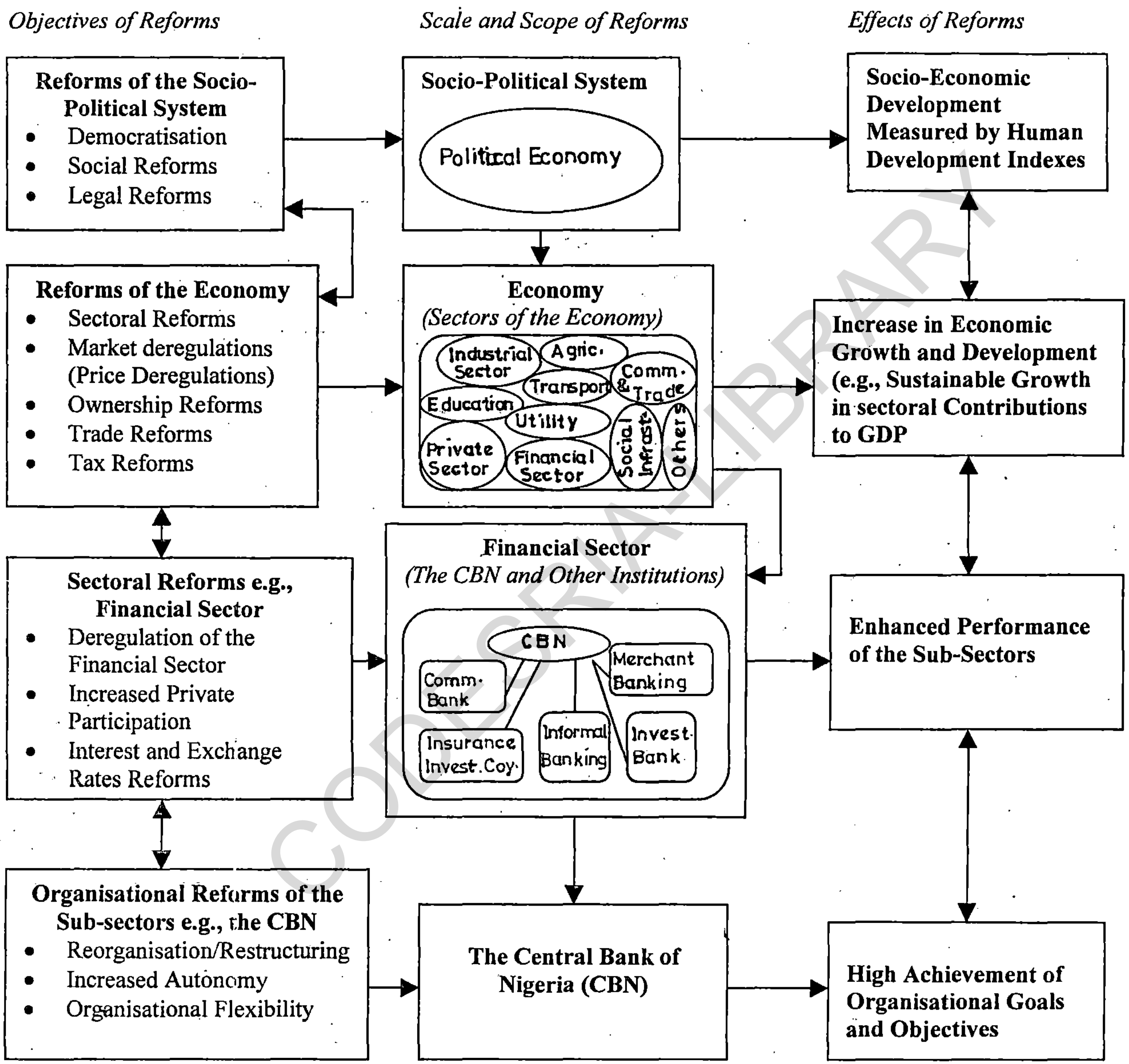
*Figure 1* **A Flow Chart of Reforms**

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The flow chart of reforms is divided into three parts. The central column indicates the socio-political system where political economy is embedded and the economy, financial sector and central bank of Nigeria is thus located therein. On the right side column are the different types of reforms which could be regarded as policy inputs to the system while the left column are the effects/results of the reforms which could also be regarded as policy outcomes. The bi-pointal arrows indicates that there is no hard and fast rule as to where the reforms should start rather the reforms in one sector necessarily affects the others as discussed in chapter two so it is a kind of cyclical flow. In all, the central bank of Nigeria is shown as a pillar on which other institutions within the financial system rest. Its reform is also central to financial sector reforms and the financial system affects the development of other sectors of the political economy.

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## 4.2 JUSTIFICATION FOR THE CBN REFORMS

The growing economic activities in the nation that was ushered in by the oil boom of the 1970s is illustrated in table 4.1 using the various economic indicators. These include growth in Gross Domestic Product (GDP), government expenditure, increase government deficit and government internal and external debts (which resulted from oil price collapsed in 1980s). Thus generating additional functions to the central bank of Nigeria and creating need for a re-structuring of the Bank in order to manage its new roles generated by the economy.

**Table 4.1** Selected Indicators of Expansion in Economic Activities 1970 – 1995 (N' million)

| YEAR | Total GDP at 1984 Constant Factor Cost | Total Govt. Expenditure | Total Govt. Deficit | External Public Debt | Domestic Public Debt | Total Debt |
|---|---|---|---|---|---|---|
| 1970 | 54148.9 | 1130.1 | - 763.7 | 488.8 | 1040.0 | 1528.8 |
| 1974 | 82424.8 | 4260.1 | - 365.8 | 322.4 | 1266.6 | 1589.0 |
| 1977 | 96098.5 | 11695.3 | - 5225.4 | 496.9 | 4636.0 | 5132.9 |
| 1979 | 91190.7 | 13191.4 | - 4323.0 | 1611.5 | 7114.0 | 8725.5 |
| 1980 | 96186.6 | 23695.7 | - 11557.0 | 1866.8 | 10399.0 | 12265.8 |
| 1981 | 70395.9 | 21238.8 | - 13969.2 | 2331.2 | 11445.5 | 13776.7 |
| 1982 | 70157.0 | 15368.2 | - 1862.2 | 8819.4 | 14847.5 | 23693.9 |
| 1983 | 66389.5 | 11525.0 | - 5290.9 | 10577.7 | 22224.2 | 32801.9 |
| 1984 | 63006.4 | 11686.4 | - 4690.4 | 14536.6 | 25675.0 | 40211.6 |
| 1985 | 68916.3 | 14828.8 | - 5105.4 | 17290.6 | 27952.0 | 45242.6 |
| 1986 | 71075.8 | 16773.7 | - 8804.3 | 42229.5 | 28451.2 | 70680.7 |
| 1987 | 70741.4 | 22018.7 | - 5889.7 | 100759.1 | 36790.2 | 137549.7 |
| 1988 | 77760.0 | 27749.5 | - 12224.5 | 133956.3 | 47031.1 | 180987.4 |
| 1989 | 83460.0 | 41028.3 | - 15134.7 | 240033.6 | 57051.1 | 297084.7 |
| 1990 | 90360.0 | 60268.2 | - 22116.1 | 298614.3 | 84093.1 | 382707.4 |
| 1991 | 94530.0 | 66584.4 | - 35755.2 | 328051.3 | 116200.2 | 444251.5 |
| 1992 | 98420.0 | 92797.4 | - 39532.5 | 544264.1 | 161900.2 | 706164.3 |
| 1993 | 100015.1 | 177310.2 | - 107186.0 | 633144.4 | 261093.6 | 894238.0 |
| 1994 | 101040.1 | 202513.0 | 70270.6 | 648813.0 | 341266.3 | 990079.3 |
| 1995 | 103217.6 | 256520.7 | 6752.6 | 716865.6 | 409598.0 | 1126463.6 |

NOTE
(-) Connote budget deficit
(+) Connote budget surplus
**Sources**: (1) CBN Statistical Bulletin
(2) Ojameruaye, E. O. (1991)

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The noticeable increased in the political economic activities is the subsequent participation of individuals and corporate bodies in economic activities, which is indicated by increased GDP. Government expenditure and deficit show that as the economy expands government gets more involved in economic activities through direct participation in production and supply of essential social infrastructures thereby increasing its current and capital expenditure which result in growing government budget deficit.

The large investment by government in expansionary economic activities then launched the government into a debt problem. This issue introduced the central bank of Nigeria into management of government debt crisis. Inevitably, all these economic expansion and problems incurred by the government rest on the CBN as a banker and adviser to the government, and whose traditional functions include designing of monetary policies that will stabilise the economy. These aroused the need and justification of CBN reforms to cope with its developmental roles for which it was created.

Considering the high level of economic activities, there was a need to increase the number and branches of commercial banks especially in the rural areas taking cognisance of the population, level of economic activities and number of established institutions in the area. Registration and supervision of banks is the function of CBN therefore with CBN reforms a tremendous growth in banking activities was recorded from 1978. In table 4.2 commercial bank branches were

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increased from 492 to 614 in 1978 and merchant banks from 1 to 7 branches in the same year. By 1986, the branches of commercial banks in Nigeria had risen to 1,367 while merchant banks have increased their branches to 27. By 1994 commercial banks branches have reached 2,403 and merchant banks 144 while the number of commercial banks have increased from 14 in 1970 to 65 in 1994 and merchant banks from 1 in the same year to 51 along with other banks and financial institutions. So at the end of 1995, the number and branches of commercial banks have reached 259 and 9,542 respectively while 204 in number and 576 in branches was recorded for merchant bank at the end of the same fiscal year 1995.

The trend of rapid growth in banking and other financial institutions through the number of banks and branches recorded correlate with increase in economic activities. However, the excess growth in banking activities with the dwindling economy led to many bank failures which marks another attainment of CBN reforms in order to improve its monetary and supervision management. The effects of the problem of insolvent banks in the financial system was the establishment of Nigeria Deposit Insurance corporation (NDIC) in 1989 as part of the reform effort by the central bank of Nigeria and the federal government of Nigeria, to assist with the problem of bank restructuring and recapitalisation – Omoruyi, (1991). Also in 1994 the federal government promulgated the failed Bank (Recovery of Debts) and Financial Malpractices Decree No. 18 of 1994 thus, further strengthening the CBN monitoring capacity (CBN Annual Report 1994).

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**Table 4.2** Bank Number and Branches

| YEAR | Commercial Banks | | Merchant Banks | | Peoples Bank | Community Banks | Finance Companies | Primary Mortgage Institutions |
|---|---|---|---|---|---|---|---|---|
| | Number | Branches | Number | Branches | Number | Number | Number | Number |
| 1970 | 14 | 273 | 1 | - | - | - | - | - |
| 1971 | 16 | 318 | 1 | - | - | - | - | - |
| 1972 | 16 | 367 | 1 | - | - | - | - | - |
| 1973 | 16 | 385 | 2 | - | - | - | - | - |
| 1974 | 17 | 403 | 3 | - | - | - | - | - |
| 1975 | 17 | 436 | 5 | - | - | - | - | - |
| 1976 | 18 | 463 | 5 | - | - | - | - | - |
| 1977 | 19 | 492 | 5 | 1 | - | - | - | - |
| 1978 | 19 | 614 | 5 | 7 | - | - | - | - |
| 1979 | 20 | 672 | 6 | 7 | - | - | - | - |
| 1980 | 20 | 740 | 6 | 12 | - | - | - | - |
| 1981 | 20 | 869 | 6 | 15 | - | - | - | - |
| 1982 | 22 | 991 | 8 | 19 | - | - | - | - |
| 1983 | 25 | 1108 | 10 | 24 | - | - | - | - |
| 1984 | 27 | 1249 | 11 | 25 | - | - | - | - |
| 1985 | 28 | 1297 | 12 | 26 | - | - | - | - |
| 1986 | 29 | 1367 | 12 | 27 | - | - | - | - |
| 1987 | 34 | 1483 | 16 | 33 | - | - | - | - |
| 1988 | 42 | 1665 | 24 | 46 | - | - | - | - |
| 1989 | 47 | 1855 | 34 | 56 | 20 | - | - | - |
| 1990 | 58 | 1939 | 49 | 74 | 169 | 1 | - | - |
| 1991 | 65 | 2023 | 54 | 84 | - | 66 | - | 23 |
| 1992 | 65 | 2275 | 54 | 116 | 228 | 401 | 618 | 145 |
| 1993 | 66 | 2258 | 53 | 124 | 271 | 611 | 310 | 252 |
| 1994 | 65 | 2403 | 51 | 144 | 275 | 813 | 290 | 279 |
| 1995 | 259 | 9542 | 204 | 576 | 275 | 1132 | 368 | 280 |

**Sources**: CBN Statistical Bulletin, and CBN Major Economic, Financial and Banking Indicators

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The aggregate bank credit to the economy in table 4.3 through government and private sector borrowing also indicate increase in economic activities thereby saddling more responsibilities on the CBN to device means of stabilising the economy. The CBN reforms take care of this through the establishment of more departments necessary to handle the new developments in the economy. It also improved its staff strength and training, and also introduced computer service to ease the working of the Bank's activities. All these testify to the pressing and expansionary economic activities in the economy leading to CBN reforms.

Moreover, the intense pressure on CBN to adopt monetary policies that will reduce liquidity of the banking system thereby combating the inflationary pressure as shown in table 4.4 in the economy, and continued depreciation of naira exchange rate also justify CBN reforms in the face of its increasing and changing role in the political economy.

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**Table 4.3** Banking System Credit to the Economy (N' million)

| YEAR | Private Sector Credit Total | Credit to Govt. Sector Total | Aggregate Credit Net |
|---|---|---|---|
| 1980 | 7190.9 | 3596.6 | 10787.5 |
| 1981 | 4654.2 | 6613.4 | 16268.5 |
| 1982 | 11371.5 | 10535.3 | 21906.8 |
| 1983 | 12353.9 | 15828.2 | 28182.1 |
| 1984 | 12942.0 | 18199.6 | 31141.6 |
| 1985 | 13700.2 | 18980.1 | 32680.3 |
| 1986 | 17365.0 | 19455.3 | 36820.3 |
| 1987 | 25476.1 | 21450.1 | 46926.5 |
| 1988 | 29773.6 | 43591.0 | 57326.3 |
| 1989 | 30942.8 | 18316.3 | 49259.1 |
| 1990 | 36631.0 | 30345.5 | 57674.9 |
| 1991 | 45325.2 | 38498.5 | 83823.7 |
| 1992 | 61020.3 | 80715.4 | 141735.7 |
| 1993 | 95285.0 | 184848.7 | 274134.3 |
| 1994 | 122273.3 | 228349.4 | 350622.7 |
| 1995 | 602189.5 | 898709.1 | 1506799.3 |

**Source:** CBN Statistical Bulletin.

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**Table 4.4** Inflation Rate

| YEAR | Inflation Rate (%) |
|---|---|
| I970 | 13.8 |
| 1974 | 13.4 |
| 1977 | 15.4 |
| 1979 | 11.8 |
| 1980 | 9.9 |
| 1981 | 20.9 |
| 1982 | 7.7 |
| 1983 | 23.2 |
| 1984 | 39.6 |
| 1985 | 5.5 |
| 1986 | 5.4 |
| 1987 | 10.2 |
| 1988 | 38.3 |
| 1989 | 40.9 |
| 1990 | 7.5 |
| 1991 | 13.0 |
| 1992 | 44.5 |
| 1993 | 54.2 |
| 1994 | 55.3 |
| 1995 | 72.3 |

**Source:** CBN Statistical Bulletin.

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## 4.3 RE-ORGANISATION OF CBN

As previously mentioned, the CBN started operation with two departments. By 1961 the number of departments have arisen to five. Against the backdrop of financial sector rigidities hindering the response of the economy to the expanding foreign exchange inflow as a result of the oil boom, the Okigbo-led Financial System Review Committee was set up in 1976 to make recommendations for a re-organisation of the entire financial system. This comprehensive financial sector reforms led to the invitation of a foreign consultants firm from United Kingdom-Mckinsey International Inc. in 1977 to review the central bank's organisation, structure and management practices Ndekwu, (1990). Following the recommendations of the consultants firm by 1978 a major change occurred in the central bank. There was a restructuring of the departments, board of directors as well as other operational procedures of the central bank to cope with the expansion of the Nigerian economy. Thus, by 1980 the departments had increased to ten in number while the board has been enlarged to thirteen members. The first new structure is illustrated in the accompanying chart (figure 2).

The recommendations of the consultants as accepted be the board of directors which the CBN used for the 1978 re-organisation are as listed below (CBN Annual Report, 1977).

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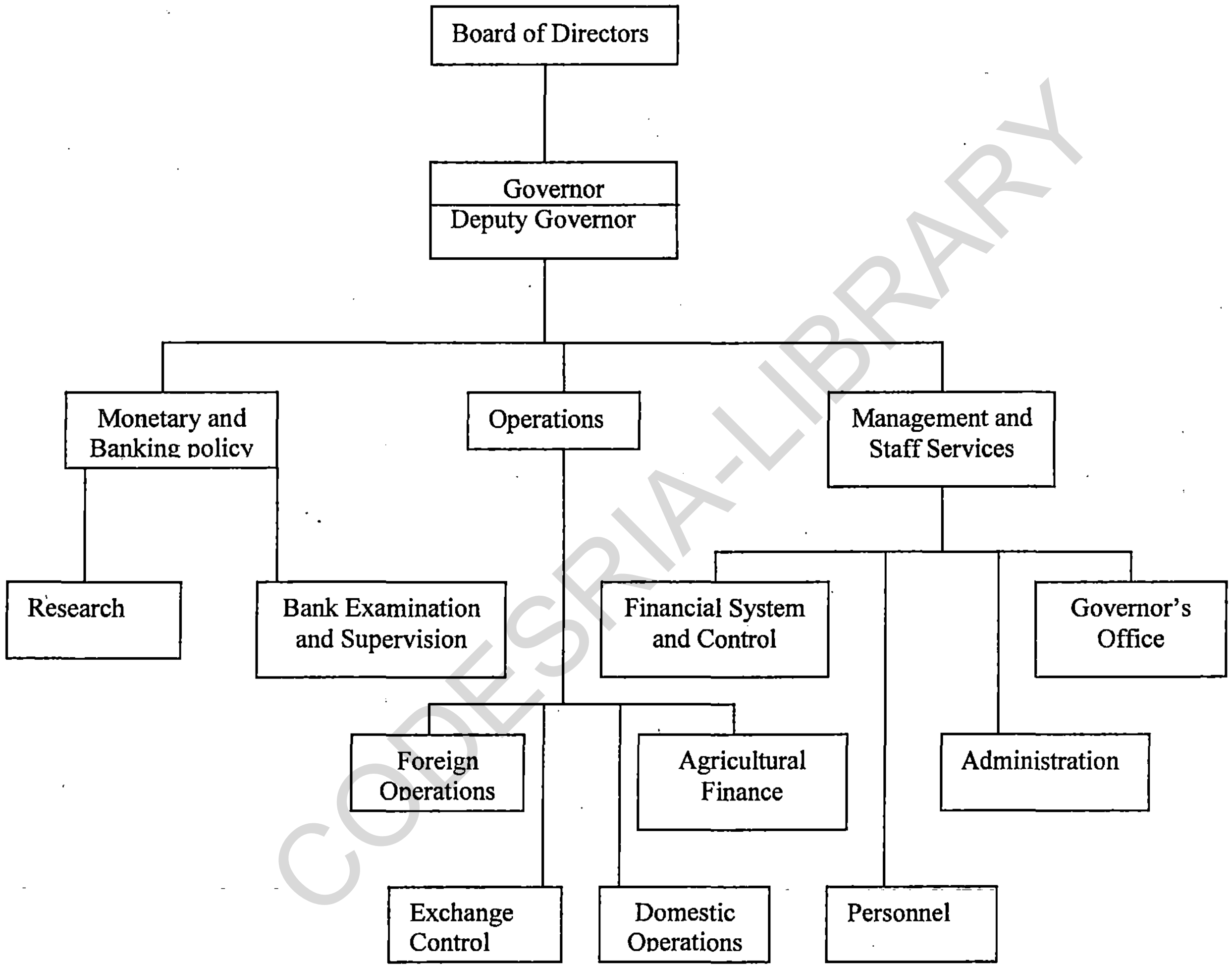
*Figure 2* **The Organisational Structure of the CBN as at 1978**




***Source*: Nwankwo (1987)**

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i. The enlargement of the Board of Directors Bank from 7 to 13 and the appointment of three Executive Directors;

ii. The restructuring of the Bank into three main groups, each led by an Executive Director:

   (a) a monetary and Banking Policy Group covering the Research and Bank supervision Departments;

   (b) an operation group made up of the Domestic, Foreign operations, and Exchange control Departments;

   (c) a management and staff services group covering the new financial systems and control Department, Personnel and Administration Departments.

   In addition, the Governor's office takes over all functions in the Bank which are not covered by (a) to (c) above. Such as, Internal Audit, Secretary's office and legal office etc.

iii. Re-styling of title of departmental heads and other staff.

iv. Introduction of a medium – sized computer.

v. Introduction of a new system of staff evaluation and improved personnel management practices.

vi. The adoption of a grading/salary structure geared to central Banking needs and total compensation package at levels more comparable with those offered by other parts of the Banking industry.

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The federal government approved the recommendations except those relating to new salary structure. It was decided that the central Bank remained within the unified salary structure for the public service established in 1975 following Report of the service Review Commission (The Udoji Report).

However, following the 1981 staff strike pressing for the removal of CBN staff from the unified salary system, the president of the Federal Republic of Nigeria, as a fall out of the strike action set up the Presidential commission on parastatals otherwise referred to as the Onosode commission charged with the responsibility which can be observed to be mostly concerned with the staff salary structure. The white paper on this was published by February 1982 approving a separation of CBN workers from the unified service salary but accompanying this privilege was a ban of CBN workers from joining trade unions. There was also a strengthening of foreign exchange transaction capacity of CBN branches in the white paper (CBN Annual Report, 1982).

By 1984 there was another consideration of ways and means of improving the organisation and operations of the CBN using the framework provided by the Mckinsey Report of 1977. Areas of interest considered by the board for reforms include the relationship of the management with the Board; the management structure of the Board and delegation of responsibilities; improvement in personnel practices; establishment of additional departments and autonomous units; departmental restructuring; budget and budgetary control and other administrative

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and institutional arrangements intended to improve efficiency in the Bank (CBN Annual Report, 1984).

As part of the 1984 re-organisation three departments were created. This include the Building and Engineering services department carved out of the Administration department, the computer unit which initially was part of the financial system and control department, was created into an autonomous computer services department, the currency operations and Banking operations departments were created from the Domestic operations department. Financial system and control department were renamed Accounts and finance department and the Governor's department was re-organised into five autonomous units which reports directly to the Governor – the five divisions are Audit, Organisation and methods, Parastatals division, Secretary's office and Security division. Also in the re-organisation was the creation of four zonal offices in Enugu, Ibadan, Bauchi and Kano to co-ordinate the work of other branches in order to curtail the span of control of the Head office relieving it to substantial routine functions and improve the efficiency of the banking system in general and the operation of the Bank in particular (CBN Annual Report, 1984). The introduction of a decentralised pattern in CBN through the reforms has been a step towards the right direction in achieving its set goals.

In 1986 the federal government introduced the Structural Adjustment Programme (SAP). The introduction of this programme marked the beginning of

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another major era of financial sector reforms. SAP, as it was widely known, was introduced to arrest the deteriorating macroeconomic developments resulting primarily from the collapse of oil prices in the world market. Therefore, an integral part of the adjustment programme apart from real and external sector policies was policies aimed at financial deepening and efficient use of financial resources through appropriate pricing. The highlights of the reforms as touching the CBN during SAP as listed by Uchendu (1996) among others include:

(a) Progressive deregulation of the naira exchange rate using different foreign exchange market mechanisms ranging from second-tier Foreign Exchange market (SFEM) introduced in 1986 to the current method of auctioning foreign exchange in the Autonomous Foreign Exchange Market started in 1995;

(b) Systematic move away from the use of direct methods and instruments of monetary control to indirect market – oriented methods and instruments, culminating in the introduction of the open market operations for the sale of government securities in June 1993;

(c) Establishment of the Nigeria Deposit Insurance Corporation (NDIC) in 1989 to insure licensed bank depositors and to collaborate with the Central Bank of Nigeria to maintain a sound and efficient banking system;

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(d) Promulgation of the Central Bank of Nigeria Decree 24 and Banks and other Financial Institutions Decree 25 all of 1991 to strengthen the regulatory and supervisory powers of the CBN;

(e) Establishment of bureaux de change to sell foreign exchange to small end-users.

Also in line with the objectives of the SAP the monetary policy circular No. 20 of 1986 was twice amended. (for detail see CBN Annual Report, 1986).

As the economy expands in volume and depth, the responsibilities of the CBN increased tremendously. There is persistent recession at home and abroad, dwindling foreign exchange earnings, mounting external debt burden, expansion of fiscal deficits and volatile and expansionary monetary policies which have grave consequences on the Nigerian economy as well as the performance of the CBN which keeps raising the clamour for a re-organisation of the CBN. Thus by 1995 because of these high needs the departments of CBN have risen to twenty-three and one autonomous unit. This new and current CBN structure is illustrated in the chart (figure 3). The chart highlights more on the structural expansion and other changes that have taken place in CBN such as the abolition of the post of Executive Directors while increasing the number of Deputy Governors to five among other changes. However, the CBN is still awaiting the government white paper on the implementation of the 1994 Okigbo Panel Report on the further re-organisation of the CBN as constituted by the federal government.

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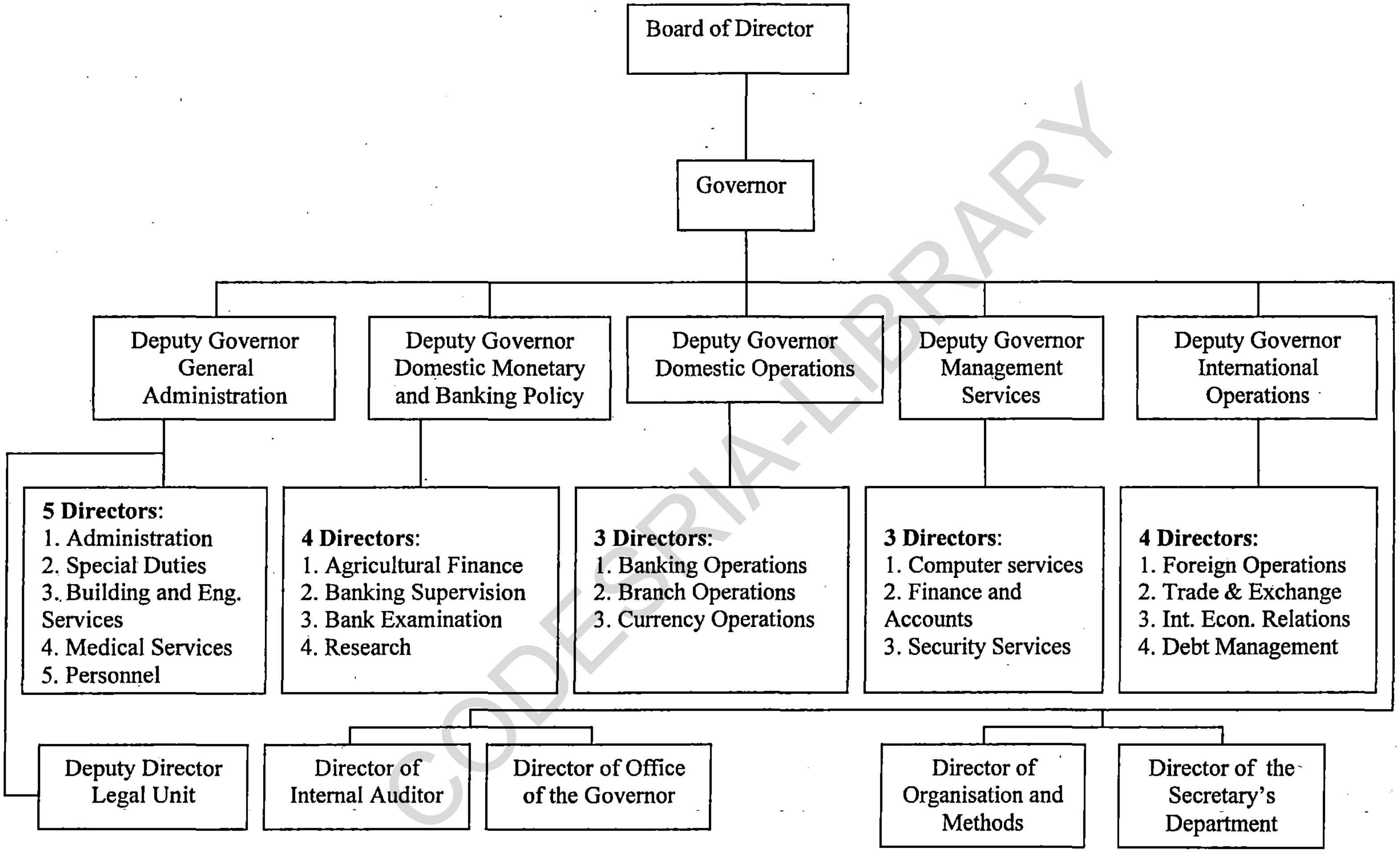
*Figure 3* **The Current Organisational Chart of the CBN**




***Source:*** **CBN**

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## 4.4 REFORMS AND AUTONOMY OF CBN

As a concept Central Bank autonomy refers to the mandate and authority a central bank should enjoy in performing its functions of maintaining monetary and price stability. Simply put (CBN Briefs 1996) defined central bank autonomy in terms of goal and instrument independence. Goal independence implies a central bank setting its own monetary target, or at least, determining how precisely the targets are specified, while instrument independence means that a central bank has authority to choose it own monetary and banking policy instruments to achieve an agreed goal.

In a cross-country comparative analysis by Falegan (1995) studies shows overtime that there is a stable price movements in advanced countries with a higher degree of independence of its central bank. Thus in Germany, Switzerland and United States low average rates inflation is recorded because of the independence of their central bank. So central-banking arrangements is widely accepted to be the most important of all structural factors in explaining differences in inflation across countries.

In Nigeria, the central bank derives its independence from the central bank of Nigeria Act, 1958 (as amended) in discharging its traditional functions which it did judiciously before the first significant measure which restricted the role of the CBN in monetary policy formulation through the amendment Act of CBN Decree 3 of 1968. This Act among other things requires the CBN to inform the minister of

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finance of the banking and monetary policy pursued or intended to be pursued by the bank (CBN 1996). The amendment Act considered the federal ministry of finance almost as a co-presenter of monetary policies in some cases. Incidentally, the central Bank only creates and initiates new policy instruments while the ministry of finance controls the policy.

Another immediate effect of this change in the status of the Central Bank is that the level of authority and precedence of Governor – minister relationship became Governor-permanent Secretary relationship. According to Falegan the golden era of Central Bank autonomy ended with the civil war. In fact the reforms brought arrogance of power and disrespect to the Governor of the Central Bank when the permanent secretary sees himself to be more important and powerful than the Governor of the bank. This could be illustrated using World Bank/ IMF incidence. Under the World Bank/IMF rules at their annual meetings, the minister of finance and the Governor of the Central Bank of Nigeria are Governors of the World Bank and IMF, respectively but in early 1980s the Permanent Secretary of Finance removed the Governor of Central Bank of Nigeria's name as IMF Governor and substituted his name which portrays lack of respect to the Central Bank in general Falegan, (1995).

Moreover, before the 1988 civil service reforms transferring the CBN to the presidency Falegan (1995), noted the consequences of the 1968 amendment Act and the 1978 reforms on CBN to include the following:

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(a) Over the years since its inception, the Bank has lost most of its independent power which have been vested in it, to the Federal Ministry of Finance;

(b) Since the Bank has little or no discretion in formulating and executing monetary policy, Government fiscal policies (especially expenditure policies) override monetary policy; and

(c) The ability of the Bank to set the course as well as a stance of monetary policy at its discretion has been severely restricted by Government's excessive spending. This limitation is reflected in the Banks little success, if any, at controlling the inflation arising from expansion of monetary aggregates.

These imply that the final decision on any monetary policy to be pursued rested with the government. In addition, the amendment Act empowered the Bank to apply specific measures of monetary control. These include: impose credit ceilings, approve commercial bank loans of certain sized, allocate and purchase stabilisation securities from financial institutions, prescribe cash reserve ratio and minimum ratio of total loans and advances which commercial bank shall grant to indigenous person etc.

Economists and policy makers, as observed by Cukierman and Webb (1995), generally feel that the degree of autonomy of the central bank from political authorities is an important determinant of policy choices and of economic performance and this could be measured by the inflation rate of the country. As

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ADB (1997) put it, a sound legal system is necessary for the sustenance of the Bank therefore the legal indexes from central bank charters could be use to measure the autonomy of the central bank through its control of price stability that will result in low inflation rate.

Political instability in Nigeria is a strong factor against CBN autonomy as it weakens the independence of the Bank from political authorities. Political changes reflect changes n basic attitudes toward economic policy, then the instability motivate politicians to control the central bank tightly and keep it at their disposal to help them stay in power. It should be emphasised at this point that incessant military incursion in Nigerian politics has made the CBN to spent most of its life span under military rule with every regime manipulating it to meet its set objectives. Thus, subjecting the Nations economy to deficit financing arising from fiscal indiscipline of the budgeting authorities of the inconsiderate military governments. This political instability worsens macroeconomic policy and outcomes and the effects are seen through inflation, real interest rate, growth rate etc while some macroeconomic deterioration result from the direct effects of political change on policy (policy inconsistency) particularly on fiscal policy.

Another constraint of the CBN came with Decree 24 of 1991 which subsumed CBN into the presidency. Segment of the Decree require the Governor of the CBN to "keep the president informed" of the monetary policy to be pursued and the subsequent presidential directive shall be binding on the Board of the Bank. The

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president was substituted in the 1991 Decree for the minister to formulate, determine and execute monetary and banking policy. This position limits the discretionary application of monetary policy instruments by the CBN. Consequently, the first defect of the Decree was the inability of the CBN to account for $12.2 billion expenditure incurred by the president and Chief Executive of the Bank, an issue that has dented the image of the bank Falegan, (1995). Today it is obvious that per capital income has dropped below poverty line and what we now have is development by destruction.

Under the new dispensation, the Bank seems to have lost its discretionary power in determining most of its functions. The anomalous situation is the Bank competing in some areas with the institutions it is supposed to regulate, that is, the banking system. In this regards the core function on which its authority, autonomy, impartial role, and prestige rest is performed by the presidency and other super-and supra-hidden bodies that press the button behind the scene.

For an efficient management of the nation's resources, the central bank which is the heart of a nation must be independent otherwise the reform of the economy and the banking industry in particular would be difficult without an institutionally and operationally autonomous central bank, commented Ekundayo, (1996). This is why government interference constraining the institutional autonomy of the CBN is a sort of concern. The amendment Act of 1968 which empowered the minister of finance to encroach upon the traditional jurisdiction of the CBN

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monetary and banking policies and the current transfer of the CBN into the presidency is more dangerous to the nations economy as CBN autonomy is completely watered down or diminished. More so, with the military reins of power, an appropriation of the rule of law in Nigeria is therefore the basic and the most sure way out of the current loss of autonomy by the CBN, and also a way-out of policy conflicts and confusion that attain present power-concentrated presidency.

The CBN should, therefore, as a matter of urgency even in the face of considerable political constraint, do all within its reach to limit the damage already done and re-establish its authority over its traditional jurisdiction. This is because it is generally agreed that liberalisation or free market economy can only thrive in a sound democratic environment. The expansion of the federal powers infringes the fundamental rights of the people and institutions and this is a direct result of military command of authority on the Nigerian society. Therefore fair play and justice is only found in a free market economy-democracy commented (Ayoade, 1998).

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# CHAPTER FIVE

# RESULT OF THE CBN REFORMS

## 5.1 INTRODUCTION

The chapter attempts a brief empirical evaluation of the results through analysis of the effect of the CBN and financial reforms on some selected variables in the political economy. The variables on which the investigation is done include the macroeconomic variables such as GDP growth rate, inflation rate, aggregate loans credits to the economy and government borrowings.

The increase of the CBN profitability, has collaborated the assertion of positive performance of the reforms of the bank. Nevertheless, since at the creation of the Bank, profit making was not a main objective, it may be a little unprincipled to rely solely on the profit analysis for the conclusion of the study. The social performance of the CBN and its reforms therefore involve the evaluation of social variables such as inflation, GDP and government borrowings.

Generally, the effects of CBN reforms are not clear-cut, there are other economic and socio-political variables that affect the policy outcomes selected by this study. For instance, the growth rate of the GDP absorbs so many socio-economic and political changes into its construction in the same way as does the inflation rate. The changes in political expectation and stability in the polity are all

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internalised in the realised changes in the GDP and inflation rate. But then, these variables are good indicators of the policy responses of CBN reforms for two main reasons. First, the control of the variables used in this study as policy-effect indicators are generally used by the CBN annually as its policy – objective variables. Second, the adverse performance in these variables are usually observed as and blamed on the ineffectiveness and inefficiency of the CBN.

## 5.2 EFFECT OF CBN REFORMS

The essence of the CBN reforms was to achieve financial and economic efficiency and growth. Empirical studies have shown that financial sector reforms have positive influences on economic performance depending on their implementation. According to El-Nil (1991), a successful financial sector reform requires political commitment, conducive macroeconomic environment, appropriate regulatory and supervisory framework, sufficient implementation time and external financial support. Proper sequencing have also been indicated in the literature as essential to a successful financial sector reform. Evaluated against this background, the CBN reforms have had varying degrees of success and problems as well as their overall effect on the ultimate targets of financial policy.

The CBN reforms have aided the enormous development of the financial sector and the growth of the Nigerian economy. A major insight can be obtained from the GDP growth rate trend and the reforms in the (financial sector) CBN. As

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shown in table 5.1 the five yearly average of GDP growth rate dipped down to (–5.64) per cent in the period 1981 – 85 corresponding to the economic depression trough. From the period of the general reforms of the political economy which was initiated in 1986, the launching of the Structural Adjustment Programme (SAP) encompassing also the CBN and financial sector reforms the GDP showed remarkable recovery from the depression. Thus, the average GDP growth period 1986 – 90 was 5.66 per cent.

In the same period there was a significant increase in the credit creation capacity in the banking sector due to increase in the number of banks and increase in the volume of savings. (see table 5.2). However, these good performances were not sustained beyond that period because of the on-going distress and other crisis in the banking sector. This is reflected in the GDP growth rate between 1991 – 95 which has once more declined to an average of 2.7 per cent. The CBN has been grappling with this problem of distress in the banking system combined with increase pressure of deficit financing by the government ever since.

It should be observed here that the increase in the autonomy of CBN especially as it affect the regulation and supervision of the banking system has enhanced the stemming of the banking crisis which could have plunged the political economy into a higher level of crisis.

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**Table 5.1** GDP Growth Rate (%)

| YEAR | GDP Growth Rate | Five Yearly Growth Rate (%) |
|---|---|---|
| 1970 | _ | |
| 1971 | 21.3 | |
| 1972 | 5.5 | |
| 1973 | 6.4 | 8.38 |
| 1974 | 11.7 | |
| 1975 | - 3.0 | |
| 1976 | 11.1 | |
| 1977 | 8.2 | |
| 1978 | - 7.4 | 3.96 |
| 1979 | 2.4 | |
| 1980 | 5.5 | |
| 1981 | - 26.8 | |
| 1982 | - 0.3 | |
| 1983 | - 5.4 | - 5.64 |
| 1984 | - 5.1 | |
| 1985 | 9.4 | |
| 1986 | 3.3 | |
| 1987 | - 0.5 | |
| 1988 | 9.9 | 5.66 |
| 1989 | 7.3 | |
| 1990 | 8.3 | |
| 1991 | 4.6 | |
| 1992 | 4.1 | |
| 1993 | 1.6 | 2.7 |
| 1994 | 1.0 | |
| 1995 | 2.2 | |

**Source:** Calculated from CBN Statistical Bulletin.

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**Table 5.2** Growth Rate in Banking System Credit to the Economy 1981 – 1995 (%)

| YEAR | Growth Rate of Aggregate Credit (%) | Aggregate Credit Net (N'million) |
|---|---|---|
| 1980 | | 10787.5 |
| 1981 | 50.8 | 16268.5 |
| 1982 | 34.7 | 21906.8 |
| 1983 | 28.6 | 28182.1 |
| 1984 | 10.5 | 31141.6 |
| 1985 | 4.9 | 32680.3 |
| 1986 | 12.7 | 36820.3 |
| 1987 | 27.4 | 46926.5 |
| 1988 | 22.2 | 57326.3 |
| 1989 | - 14.1 | 49259.1 |
| 1990 | 17.1 | 57674.9 |
| 1991 | 45.3 | 83823.7 |
| 1992 | 69.1 | 141735.7 |
| 1993 | 93.4 | 274134.3 |
| 1994 | 27.9 | 350622.7 |
| 1995 | 329.7 | 1506799.3 |

**Source:** CBN Statistical Bulletin.

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There is however, a political connotation to the current banking crisis in Nigeria. Sequel to the annulment of the June 12, 1993 Presidential Election result, there were whimsical protest, interregnum of political confusion and social insurrection. This chaotic situation gave an impetus to massive banking and financial malpractices and high scale fraud, mainly with the expectation that the political crisis, which started with the annulment, will persist and deteriorate into war.

Going by the classical evaluation of the measurement of organisational performance, analysis of profit is a very important parameter for drawing inference about the success or failure of any organisation. Although profit making is not the primary objective of the CBN, it has been making huge profits, which in its accounting term are regarded as operating surplus. As Ndekwu (1990) observes the CBN is one of the most profitable government owned organisations in Nigeria. Their operating surplus is usually transferred to the government at the end of every accounting period, usually one year. The growth in the operating surplus can therefore be used to represent the positive increase accruing to the CBN as a result of its institutional reforms. Generally, the operating surplus of the CBN transferable to the government coffer has been consistently increasing since the establishment of CBN.

However, there has been a remarkable improvement in the profit making capacity of the CBN since (1986) SAP reforms which had since encompassed financial and CBN reforms, see table 5.3. Nevertheless, the conclusion drawn from the operating surplus displayed on the referred table should be done with some

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reservations. First, the increase in the operating surplus could be due to the inflationary pressure in the economy culminating in the mass devaluation of the naira and the general increased in the government deficits. Second, and directly related to the above had been the sporadic increased in the volume of business activities of the CBN during the (1990) mass increase in the number of banks some of which has failed. As the economy stabilises therefore, some of the sources of the surpluses are likely to be eroded away. Nevertheless, the current trend in the CBN profits is an indication of improved performance due to the CBN reforms. The operating surplus therefore could be regarded as the best single indicator of measuring the CBN policy achievements since it is more or less independent of the performance of other economic sectors. .

Despite the growth recorded in the economy and the profitability of the CBN, some problems remained while new ones developed, the most prominent being the financial institutions' distress. It has been observed that the rapid expansion of the financial sector as a result of the reforms has been identified as one of the contributing factors to the distress facing the financial sector. This is related to the thin spread of qualified management staff among the new institutions. The effect of this poor management and control contributed immensely to expanding non-performing loans, embezzlement and mismatch of funds, which result in part to the current financial distress.

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**Table 5.3** Operating Surplus for the Year 1980 – 1995 (Ascertained in Accordance with Section 7 (4) and Part 11 Section 5(4) of the Central Bank of Nigeria Act and Degree 24, 1991).

| YEAR | N' 000 |
|---|---|
| 1980 | 210504 |
| 1981 | 376860 |
| 1982 | 289249 |
| 1983 | 309690 |
| 1984 | 556119 |
| 1985 | 550513 |
| 1986 | 570700 |
| 1987 | 601145 |
| 1988 | 978133 |
| 1989 | 1787143 |
| 1990 | 3202143 |
| 1991 | 6299854 |
| 1992 | 6966094 |
| 1993 | 11591409 |
| 1994 | 6053595 |
| 1995 | 5977297 |

**Source**: CBN (various issues) Annual Report and Statement of Accounts.

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Moreover, the issue of poor management and internal supervision had resulted in a fraud of N40 billion in the Debt Management Department (DMD) by staff of the department. Debt management department is one of the departments created during the re-structuring of the CBN as a child of necessity to cater for the developmental need of managing the government increasing debt problem (Abimboye, 1997). This scandal portrays or exposes the internal weakness of lack of checks and balances within the decentralised authorities of the apex bank. Thus, decentralisation, which was meant to aid in the achievement of organisational policy/goals efficiently, had been turned into a crime perfection/specialisation device of achieving individuals or groups aim. The abuse of the concept of decentralisation through decentralised corruption in the apex bank has left a room for questioning on the contending autonomy which, the CBN is seeking from the government.

Furthermore, the extent and consequences of the CBN reforms can be evaluated in terms of the interaction between it and the government. This can be done through analysing the magnitude of loans to the government from the Bank. Usually, the government may raise funds from the banking system or the general public passing through the CBN which issues and sell to them on behalf of the government, the treasury bills and certificates. In Nigeria, however, these issuance and sells of the government credit instruments often start and end almost as an in-house activity at the CBN. This is because public purchases of such instruments are very small compared to the CBN purchases and payment to the government.

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Even though the CBN is supposedly an impartial adviser to the government in monetary matters, it is however placed in a very difficult situation in Nigeria in respect of inflationary financing of the government deficits. As shown in tables 4.3 and 4.4 in the previous chapter, the CBN lending to the government as well as the rate of inflation has been increasing with high level of correlation. Many factors may be responsible for inflationary pressure in addition to the CBN money but the public sector deficits are more or less the sole activity of the apex bank.

Therefore, when analysing the autonomy of the CBN it is pertinent to observe that the direct reporting to the presidency has greatly facilitated government deficit financing. It has also reduced the ability of the bank to stand by its advice to the government of the day on inflation and monetary matters. So long as the CBN is regarded by the government as one of its institutions created with the aim that it should carry out its functions, the government will always expect that the bank must perform these functions whatever the situation may be. Since one of the functions of the bank is financing the government deficits then, it would be inimical to leave the autonomy and control of the CBN entirely in the hands of the presidency of which it was created to also be an adviser. The transfer of the supervision and control of the CBN to the presidency in Nigeria under the military dictatorship has particularly brought loss in the autonomy of the CBN.

However, the abrasion in the autonomy of the CBN should only be interpreted in the light of the general erosion in individual and institutional

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autonomy, which is generally observed in the military administrations of this country. The military style of leadership is that of directive and automatic orders with limited room for consideration of advice from institution or individual. The CBN loss of autonomy should, therefore, be seen as the military phenomenon in government, which is not special of or peculiar to the CBN.

Nevertheless, amidst all the conflicts and constrained autonomy faced by the CBN, the achievement of the Bank in stemming the inflationary pressure generated by the SAP policies should be acknowledge. Again, many institutions and agencies have contributed towards the bold management and achievement but at the centre of this is the CBN

In fact there is need to stress that policy reversals, unstable social and political environment, unsustainable external debt service and epileptic and inadequate external capital inflow also hampered the full implementation and impact of CBN reforms.

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# CHAPTER SIX

# CONCLUSION

## 6.1 SUMMARY

This study attempts to explore into the political economy of the CBN reforms in Nigeria. The work was initiated against the background of the need to understand the dimensions and effects of the CBN reforms in the political economy of Nigeria. The central aim has been to evaluate the effectiveness of the internal structural changes in the CBN and its autonomy on the policy achievements.

In antecedent, it has been observed that the CBN has undergone the two major comprehensive financial system reforms along with other minor internal re-organisations. This has been in response to the increase in socio-economic activities within the political economy which had imposed on it additional roles and responsibilities in the course of socio-economic transformation of Nigeria. Consequently, the post of the existing three executive directors were abolished and replaced with five deputy governors. Also, the number of departments was increased from ten (10) in 1980 to twenty - three (23) as at 1995.

Besides, to stem the policy conflict arising from the dual reporting channel of the CBN to the minister of finance and the presidency, the Phillip's committee recommendation that the CBN be responsible only to the presidency was

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implemented. This has helped in controlling the antagonistic and personality conflict between the permanent secretary of the ministry of finance and the CBN Governor thereby restoring a mutual relationship between the two government bodies.

In the course of reforms of the CBN, greater level of reforms execution have been recorded in those aspects that have to do with the structural transformation of the CBN than those on autonomy. The low level of implementation of the CBN autonomy is attributed to the deepening government interest in the institution, the major of which interest is government deficit financing facilities of the CBN.

It has been evaluated that, the ability of the CBN to managed the ever expanding activities in the political economy of Nigeria should be a commended achievement of the continual CBN reforms. Principally, the management of inflation in the Nigerian economy given the inflationary pressure of SAP reforms has been reckoned to have been possible due to the CBN reforms. Another major achievement has been the economic recovery from a deep depression which started in the early 1980s. This is demonstrated by increase in the growth rate of GDP in the 1990s. However, there are other economic and socio-political factors that facilitate the achievement of the CBN with respect to control of inflation and stimulation of economic growth whose evaluation is outside the scope of this study.

Perhaps the most conservative indicator of the CBN achievement, the operating surplus transfers to the government, is a major proof of the increased

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performance of the CBN. This too, cannot capture the social goal or the CBN operations such as control of inflation and increase in economic growth.

The study also observed that the responsibility of the bank as monetary adviser to the government has been grossly eroded due to the relative weakening of the CBN autonomy. This has been depicted by the growth in government deficit financing.

Furthermore, due to the diminishing autonomy of the CBN, the procedures for the establishment and operation of banks were uncontrollably liberalised by the government, which has been responsible to the mass bank failures of the 1990s.

## 6.2 RECOMMENDATION

Based on the observations made by this study, the following recommendations are presented for considerations by the CBN which if taken into account by the policy-makers of the Bank would further boost the echo of the Bank in policy achievements as well as redeeming its gradual deteriorating image before the Nigerian public.

(a) An organisational strategy that would emphasise pronouncement on monetary and banking matters with authoritative data should be embarked upon by the CBN. Moreso, the policy makers of the apex bank should seize the initiative of undertaking economic issues of general interest to the nation.

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(b) Internal checks and balances within the organisational departments, zonal offices and branches should be emphasised and made to be more efficient than what it used to be. This will enhance greater accountability and good exemplary leadership in economic recovery and development which the apex bank is supposed to exhibit.

(c) The CBN should, even in the face of the current political constraint do everything possible to secure and consolidate institutional clout through courageous leadership, deftness and professionalism in handling of the core central banking issues.

(d) With the low level of political culture in Nigeria and incessant military incursion in the Nigerian politics with their commanding might, it is pertinent to return the CBN to the Federal Ministry of finance in order to safeguard the autonomy of the CBN. However, while doing this, there should be a clear-cut division in functions to be performed by the two bodies in terms of their relationship.

(e) Also, the members of the board of directors of the CBN should not be politically inclined. They should not compromise their term of office with the traditional functions of the Bank because this will indicate a betrayal of their profession, which they should rather defend. Thus, the leadership of the Bank should become more strategically oriented, especially with respect to the better monitoring of an increasingly hostile external environment.

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## 6.3 CONCLUSION

It is observed by this study that the CBN reforms have enhanced its performance and policy achievements generally. Although the situation can still be improved through granting a greater scope of autonomy to the CBN, such autonomy must be under an effective control and regulation of the government compared to other public enterprises and institutions. Thus, considering the high level of interaction between it and the different government in Nigeria, the CBN has performed creditably well. However, loosening it ties to the government in some respect, especially as it affect the control of the financial system would enable the bank to developed and control a strong and dependable financial sector in the growing political economy of Nigeria.

Nevertheless, the evaluation of the CBN reforms should be seen in the context of the matrix of activities that have occurred in the entire political economy. Greater results of the CBN reforms could be realised if there are general reforms in other sectors and sub-system of the entire political economy. Moreover, any deregulation or reforms that makes any institution or sector to depend more on free market operations requires as a basic necessity the political reform that would make the entire political economy to be a free democratic state.

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