Rethinking Monetary and Fiscal Policies in Nigeria

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Abstract

The objective of this paper is to review the practice of monetary and fiscal policies in Nigeria since independence. It shows how oil has turned Nigeria from a revenue generating to a revenue sharing nation. This has led to immense difficulties in enshrining fiscal discipline at all levels of government. Given the underdeveloped nature of the country's securities market, it is not surprising that monetary policies have consistently been ineffective in this environment of fiscal dominance. Finally, the paper argues that curbing the fiscal indiscipline of Government will take much more than enshrining fiscal policy rules in our statute books. This is because the statute books are replete with dormant rules and regulation. For any meaningful progress towards fiscal prudence on the part of Government to occur, some powerful pro-stability stakeholders strong enough to challenge government fiscal recklessness will need to emerge.

Introduction

A key function of all central banks including the Central Bank of Nigeria is to promote and maintain monetary stability and a sound financial system. The assumption is that this will help encourage long term planning, aid infrastructural development, attract foreign investments and engender economic growth. While the central bank is totally responsible for the promulgation of sound monetary policies in order to aid the attainment of the above objectives, the formulation of fiscal policies, which also affects the achievement of the above objectives, however falls on the wider government, particularly the Ministry of Finance.[1] Given the fact that both monetary and fiscal policies impact on economic growth and development, it is not surprising that they are entwined. This relationship has been explicitly explained thus:

Fiscal and monetary policies are inextricably linked in macro economic management; developments in one sector directly affects developments in the other. Undoubtedly, fiscal policy is central to the health of any economy, as government's power to tax and to spend

[1] Monetary policy is usually concerned with the use of changes in money supply and/ or interest rates to influence the level of economic activity. It is anchored on the use of all or some of the following policies: Open Market Operations, Liquidity rations, rediscount policy, minimum reserve requirements and sectoral credit guidelines. On the other hand, fiscal policies involves the use of taxes and changes in government expenditure to influence the level of economic activity (Ekpo, 2003, p.15).

affects the disposable income of citizens and corporations, as well as the general business climate. In this regard, the interrelationship between public spending and private sector performance is of paramount importance. On one hand, Government expenditure can provide an impulse for private sector growth, while on the other, it can be harmful if it results in budget deficits and leads to competition for scarce financial resources from the banking sector as the government seeks to finance the deficit. In such circumstances, the crowding out of the private sector by the Government sector can outweigh any short-term benefits of an expansionary fiscal policy. The key to all theses therefore lies in striking a good balance in fiscal management. [Having] enough expenditure outlays to meet the needs of Government and support growth, but not so much as to deny the private sector the resources it needs to invest and develop.[2]

Furthermore, Government fiscal recklessness resulting in deficit financing can also cause inflation, which contradicts the fundamental monetary policy objective of price stability.[3] This has the potentials of destabilizing the macro economic environment thereby retarding economic productivity and development. The objective of this paper is to review the practice of monetary and fiscal policies in Nigeria since independence. In doing so, we hope to explore the following issues: the link between government and development; how monetary and fiscal policies have affected past developmental programmes in the country, and; the difficulties of conducting monetary and fiscal policies in a deregulated environment and in an era of globalisation.

The link between Government and Economic Development

The key function of government be it democratic or military, is to protect and promote the welfare of its citizens. In doing this, the Government must choose the economic approach to pursue. It may, for instance, decide to pursue a control economic approach, a free market economic approach or a synthesis of both. Whichever one it decides to pursue is determined by the social, political and international politics of the time. It is important for us to emphasize the fact that all forms of governments are essentially social constructs. It is not the intention of this paper to pass judgment on the “right” or “wrong” form of Government. The important thing is that whatever form of Government that is in place the objectives are similar. Monetary and fiscal policies play a key role in the promotion of the main government objective of promoting the welfare of its citizens.

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[2] Okonjo-Iweala, 2003, pp. 285-6.

[3] There is no doubt that the current consensus is that the overriding appropriate economic objective of a central bank should be the achievement of price stability. This consensus however does not necessarily turn this objective into an eternal verity. Occasions and situations like war, internal rebellion, financial collapse and massive unemployment have led to differing ideas about the appropriate aims of a central bank (Goodhart, 1991, p.20).

In his budget speech shortly before Independence in 1960, for instance, the then Finance Minister, Chief Festus Okotie-Eboh made it explicit that the financial and economic policies of Government would be directed towards "the achievement and maintenance of the highest possible rate of increase in the standard of living." He then announced the following ten point objective of Government: to maintain confidence in the value of the local currency and to maintain reasonable stability in wages and prices; to continue to expand the basic infrastructure upon which all developments depend; to give every support to increased agricultural production; to continue to encourage the growth of industry and the further development of Nigeria's mineral resources; to promote the training of Nigeria's manpower especially in professional, technical and management skills; to ensure that development works are undertaken in accordance with their priority and importance to Nigeria and that there is proper coordination between all the governments of the federation in this field; to make effective arrangements for the provision of the funds required to finance development in Nigeria both by mobilizing domestic resources and by attracting capital from overseas; to continue to develop the social amenities increasingly required in accordance with the ability to sustain them; to ensure that Nigeria plays her full part in the international institutions and organizations designed to promote development and freer and wider international trade, and; to ensure that Nigeria plays her full part both as a donor and a recipient in international technical assistance schemes.[4] Since Independence till date, the above objectives of government have barely changed. The few changes that have appeared in government budgets and policies have been of degree rather than of kind.

In 1971, for instance, shortly after the Nigerian Civil War, the then Head of State, General Yakubu Gowon identified the following problems as the most serious confronting the economy: the deteriorating foreign exchange situation and the continuing unfavorable balance of payments; the critical unemployment situation in the country, and; the rising inflation and cost of living.[5] By the time President Shehu Shagari took over the reigns of governance from General Olusegun Obasanjo in 1979, he painted a very distressing picture of the economy he inherited from the General. According to him:

> As at 30th September 1979, the last day of the military regime, the overall financial position of the federal government showed a deficit of N1.4 billion (N1,403,621,928). The Federal Government was not alone in this dilemma. The State Governments were in the same predicament and were likewise unable to meet the contractual obligations and, naturally, this affected the performance of the economy generally both in the public

[4] Quoted in Central Bank of Nigeria Annual Report, 1960, pp.13-14.

[5] See 1971/72 Budget Speech, p.4.

and private sectors. On the external front, our debts rose sharply from about N54 million in 1975/76 to N364 million in 1978/79.[6]

In 1983, the Shagari administration was ousted by the Military on the grounds of inept economic management and corruption. Despite this, there was little improvement in the country's macro economic management. If anything things got worse. Even the Military Government failed to ensure any form of fiscal policy discipline. This was so despite the adoption of the Structural Adjustment Programme (SAP) in 1986.[7]

By the time the military left office and handed power over to General Obasanjo (now a civilian) in 1999, the problems of the country had changed very little. In his 2000 budget speech to the National Assembly, President Obasanjo asserted that:

> On the assumption of office in May last year, our present administration inherited a prostrate economy characterized by low capacity utilization in the real sector, poor performance of the major productive sectors, import dependence, indiscriminate influx of substandard imports at ridiculous landing costs, and declining foreign exchange earnings. Other noticeable features were high operating costs and inflationary pressures as well as unfavorable legal and fiscal environment for the private sector to become the effective engine of growth for development in the economy. The weak and import dependent industrial base and the low productivity in the agricultural sector left the economy vulnerable to macroeconomic and fiscal imbalances.[8]

From the above, it is clear that despite the extensive lip service that has been paid to the need to engender economic growth and development through the provision of a stable macroeconomic environment and developmental infrastructure, there has been very little progress in this direction. In the pursuit of most of the above objectives, fiscal and monetary policy tools are central. Despite the extensive use of the above policies, very little progress has been made towards the achievement of the nation's economic objectives. If any thing, the country is poorer today than before the oil boom.[9]

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[6] 1980 Budget Speech, p.4.

[7] It has, for instance, recently been noted that: "Government deficits have posed significant problems for the country since the oil boom of the '70s. Expansionary fiscal policies prompted by the favorable oil proceeds in the international market resulted in large fiscal… deficits and the rapid build up of external and domestic debts. With expenditure rising faster than revenue, deficits grew from an average of 5.0 percent of GDP in 1983-86 to 10.3 percent in 1991-94 before declining to 4.9 percent in 1999-2002. The deficit problem has remained persistent because of government's inability to reduce the level of expenditure to sustainable levels" (Alade, 2003, p.8).

[8] Budget Speech 2000 (reproduced in Business Times, Monday, January 24, 2000, p.25.

One possible way of understanding this lack of progress is by examining the nature of monetary and fiscal policies in our country.

Monetary and Fiscal Policies Prior to SAP

There is no doubt that the failure of government fiscal policies, rather than the failure of monetary policies, is the main reason why most of the past developmental programmes undertaken by the Government has come to naught. This is so despite the fact that the conventional theory tends to suggest that a central bank uses monetary policy instruments to predominantly influence the general price level. This broadly translates into the monetary theory of the price level, which implies monetary dominance in the determination of the price level. In reality however, fiscal policy is sometimes dominant. This is especially so in countries with underdeveloped securities markets which essentially limits the ability of a central bank to effectively develop and use monetary policy instruments. This has been explicitly explained thus:

> In principle fiscal dominance occurs when fiscal policy is set exogenously to monetary policy in an environment where there is a limit to the amount of government debt that can be held by the public. Hence if the inter-temporal budget constraint must be satisfied, fiscal deficits would have to be magnetized, sooner or later. In fact when the size of the financial system is small relative to the size of the fiscal deficits, a central bank may have no choice but to magnetize the deficits. Thus… in countries with shallow financial systems, monetary policy is the reverse side of the coin of fiscal policy and can only play an accommodative role. In such low income countries, government securities markets are underdeveloped and central banks do not hold sufficient amounts of tangible securities and the central bank's lack of suitable and adequate instruments of monetary control constitutes one of the factors that induce fiscal dominance…. Where fiscal dominance applies, the country's economic policy is only as good as its fiscal policy and an institutionalized central bank independence may not necessarily bring about an independent monetary policy.[10]

There is no doubt that Nigeria clearly meets all the requirements for fiscal dominance. In fact concerns about the fiscal dominance nature of the country, especially the underdeveloped securities market predates the advent of central banking in the country. Such debates also featured prominently in the debate as to whether Nigeria deserved a central bank.

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[9] Herbst (1996, p.159) and Uche and Uche (2004, p.41).
[10] Oyejide, 2003, pp.208-9.

Monetary activities in Nigeria during the pre-central banking era were overseen by the West African Currency Board (WACB), which was established in 1912 with headquarters in London.[11] The constitution of the WACB charged it "to provide for and to control the supply of currency to the British West African Colonies, Protectorates and Trust Territories." In practice however, the board was no more than a *Bureau de Change* issuing as much local currency as the banks wanted to buy for sterling and vice versa. It was therefore not in the technical sense, a monetary authority. Such a system, however, satisfied the Bank of England monetary policy objective of achieving price stability in the colonies.

Price stability and parity conversions however had its cost: the ability of the WACB to create credit was severely hampered. This pre-central banking system also perpetuated a situation where large parts of Nigerian Government funds were held abroad. This further reduced the amount of money available for indigenous development. Access to credit was indeed what the Africans, rightly or wrongly, believed that they needed most if they were to break away from the shackles of colonialism. Dispensing with the colonial monetary system in favour of a central bank was therefore an integral part of throwing off the economic shackles of colonialism.[12]

Maintenance of the WACB status quo, no doubt, ensured the preservation of the seigniorage gains of the British Government from the colony. There were however other reasons for the Bank of England's opposition to the establishment of a Nigerian central bank. Such opposition was also based on the belief that central banks were of little use in countries with underdeveloped securities markets. Also, the Bank of England feared that central banks in newly independent developing countries might be unable to adhere to sound principles of monetary management, especially when exposed to political pressures.

Also, the relevant tools for the effective conduct of monetary policy were not in place at the time. For instance, by the time the Nigerian Central Bank was eventually established in 1959, there was no money and capital market in existence in the country. As the then Finance Minister noted:

> In countries where there is a developed money or capital market it is common for Central Banks to purchase or sell securities on the open market and to employ a flexible bank rate as means of managing the economy. Of course, as yet we have no money market in Nigeria which could enable the Central Bank to employ these

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[11] The other members of this Board were Gold Coast (Ghana), Gambia and Sierra Leone. The four territories were served by a single currency under the WACB regime.

[12] This section draw extensively from Uche (1997a, 1997b).

> techniques and until a market is developed other techniques will have to be adopted... the fact that our export trade is dependent upon agricultural products, the prices of which are subject to wide variations in the world market, will restrict the extent of the monetary management the Central Bank can employ.[13]

Any central bank established was, therefore, *ab initio*, likely to come under enormous inflationary pressures and be poorly equipped to combat such pressures.

The final push for the establishment of a central bank in Nigeria came in 1955 when a World Bank Report endorsed the idea. Essentially, the recommendation of the World Bank was, at least in part anchored on the argument that to postpone the date when functions of currency issue and the management of foreign assets are performed in Nigeria will also postpone the day when trained Nigerians will be able to perform these functions responsibly by themselves.[14]

The Central Bank of Nigeria was subsequently established in 1958. The bank's principal objects were to issue legal tender currency in Nigeria, to maintain external reserves in order to safeguard the international value of the currency, to promote monetary stability and a sound financial structure in Nigeria and to act as a banker and financial adviser to the Federal Government.[15] The British Colonial Government ensured that the Central Bank of Nigeria Banking Ordinance of 1958 which it midwifed, contained a clause specifically stating that:

> The value of the reserve... shall- (a) for a period of five years... be not less than the aggregate of an amount representing sixty *per cent* of the Bank's notes and coins in circulation together with an amount representing thirty-five *per cent* of the Bank's other demand liabilities; (b) after five years... be not less than forty *per cent* of the aggregate of the Bank's notes and coins in circulation and other demand liabilities.[16]

With the expiration of the period however, this clause have since disappeared from the statute books and the central bank under pressure from government has buckled and has now become the main financier of government deficits.

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[13] Given the above scenario, it was therefore not surprising that it as not until 1969 that the CBN effectively started issuing monetary policy circulars.

[14] IBRD, 1955, p.97.

[15] See section 4 of the Central Bank of Nigeria Ordinance 1958.

[16] Section 26.

Undoubtedly, the most important factor that has impacted on both the level and character of fiscal policy in the country is the advent of oil as the main stay of our economy. Over dependence on oil resources and the volatility of the oil market has been transmitted to the rest of the economy. This has been explained thus:

> With about 75 percent of revenue from oil and gas, fiscal policy in Nigeria has been heavily influenced by oil driven volatility impacting both revenue and expenditure. Since 1970, both revenue and expenditure have been very volatile while increasing over time. In periods with high oil prices, such as in 1979- 82, 1991-92, and more recently in 2000-02, revenue and expenditure have increased sharply. This has typically been followed by the scaling back of expenditure as oil prices subsequently decline, though at times with a lag. The implications of such boon-bust fiscal policies include the transmission of oil volatility to the rest of the economy as well as disruptions to the stable provision of government services. This has added to the failure over the years of public spending. Neither facilitating the diversification and growth of the non-oil sector nor reducing poverty.[17]

Aside from the negative impact of the transmission of oil volatility to the rest of the economy, the enormous oil windfalls have helped alter the country's revenue allocation formula by facilitating the change in focus from revenue generation to revenue sharing. The implication of this is that Nigeria has essentially become a rentier state where sharing of assets is based not on economic justification but political control. The consequence has been the development and growth of an unproductive civil service, proliferation of local governments, states and government agencies and institutions with doubtful productivity value. On the issue of new states, for instance, a former Nigerian President once noted that:

> It is hard to see what contribution the creation of yet more states will make to our recovery and progress… Civil servants will earn rapid promotion and businessmen and women a fresh wave of contracts for more prestigious buildings and projects. This will be it… No new resources are likely to be generated either from taxes, production or services. Dependent on federal handouts and ill equipped to perform their functions, the new states will simply be a drain on already limited resources… This is not development. It is absurdity.[18]

[17] Baunsgaard, 2003, p.5.

[18] Quoted in Suberu (1998, p.286). It has also been argued that: "One implication of this continuous growth in the number of states and local governments is that the statutory allocations of each tier of government have dwindled and became inadequate for supporting their total expenditure. The creation of new states and local governments tend to induce high overhead costs such as increased provision of secretariats, staff emolument, rental of buildings, etc, (CBN, Annual Report, 1997: 79)

The result of the above is that most of the oil windfall, which could have been used to create the enabling infrastructural environment for industrial take off has been frittered away. The constitutional requirement spreading revenues across the three tiers of government has also complicated the process of fiscal policy management in the country. This is because even if the Federal Government has the political will to control its spending it may not be very easy to get the states and the local governments to tow the line. This has been explained thus:

> The Federal Government's efforts are handicapped by the constitutional requirement to pass through a large share of oil revenues, and the states and localities have corresponding constitutional responsibilities for essential social services (primary education, primary health and rural infrastructure). As the later is ill defined, there is a political incentive to be expansive in determining what capital expenditures should be funded. The Federal Government has already lost a challenge in the courts over the pass-through requirement, and is mandated to finance certain state and local expenditures, including primary education and basic health. Thus actual share over which the federal government has free reign is less than half, and the share is itself challenged by the parochial interests of members of the National Assembly who have incentives to seek expenditures for their constituents and special interests.[19]

Given the above scenario, especially the dominance of fiscal policies, it is not surprising that enormous confusion has reigned over the conduct of monetary policies in the country all in the attempt to engender economic growth. The monetary policy terrain has even been made more difficult by the lack of a developed securities market. For instance, as already stated, despite the fact that the Central Bank was established in 1958, it was not until 1969 that its first structured monetary policy circular was officially published. The policy thrusts of this maiden monetary policy circular were: to conserve foreign exchange reserve, raise sufficient funds to finance the war and to reinvigorate economic activities in the private sector. In other to achieve the above objectives, the CBN approved an increase of 50 percent in credit over the end 1968 level by the banking system to the government sector. Furthermore, it increased the credit allocation for financing of production, general commerce and services.[20] Once the war ended, the objective of the CBN monetary policies also changed. The 1970 monetary policy, for instance, was aimed at reducing inflationary pressures, restoring normal economic conditions, relieving the pressures on the external payment position, and reducing government dependence on the banking system. In order to achieve the above objectives, the CBN

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[19] Ott, 2003, p.78.

[20] CBN Annual Report, 1969, p.13.

directed that aggregate credit to government outstanding at the end of 1970 was not to exceed 20 percent of the 1969 level. Furthermore, increases in credit to the industrial sector, general commerce and services were limited to 40, 10 and 50 percent respectively. In the same year, the CBN further directed each commercial bank to grant on the average a minimum of 35 percent of its loans, advances and discounts to indigenous borrowers.[21] In subsequent years, control of inflation and the need to create a stable macro economic environment remained a persistent concern of the monetary authorities. The oil boom and the consequent Government fiscal indiscipline ensured this. At the policy level, the CBN continued to experiment with various mixes of sectoral allocation of credit. Also loans and advances to indigenous borrowers continued to rise in the spirit of the indegenisation fever at the time, increasing to 70 percent in 1979 and 90 percent in 1984. In order to engender rural development, the CBN also introduced the rural banking scheme in 1977. In 1982 all banks were directed to lend a minimum of 30 percent of their total deposits generated from their rural areas to the customers in the rural areas. This was increased to 40 percent in 1985.[22]

Sometimes, Government has, in their desperate measure to control inflation undertaken monetary policies that have had disastrous long-term consequences. Take for instance the sudden change of currency colour during the Buhari regime in the 1980s. This no doubt reduced the amount of money in circulation and thus impacted on inflation. However, it led to a major loss of confidence in the Naira and damaged its ability to serve as a regional currency for West Africa. This was because huge Naira reserves held outside the country, especially in the West African sub-region, were essentially demonetized in the process.[23]

The failure of all the above monetary policy variants to engender the stable macro economic environment necessary for economic growth and development in the face of fiscal dominance led to the adoption of The Structural Adjustment Programme (SAP) in 1986.

SAP, Monetary and Fiscal Policies and Economic Development

After several years of control economics, the Babangida Administration, under pressure from the International Monetary Fund and the World Bank, launched the Structural Adjustment Programme (SAP) in July 1986. It was designed to achieve balance of payment viability by altering and restructuring the production and consumption patterns of the economy, eliminating price distortions,

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[21] CBN Annual Report, 1970, 13.

[22] CBN Annual Report, 1985, pp.8-9.

[23] I am grateful to Dr. Walter Ofonagoro for this point. For a general review of monetary cooperation in ECOWAS, see Uche (2001).

reducing the heavy dependence on consumer goods imports and crude oil exports, enhancing the non oil export base, rationalize the role of the public sector, accelerating the growth potential of the private sector and achieving sustainable growth.[24] To achieve the above objectives, the main strategies of the programme were the adoption of a market determined exchange rate for the Naira, the deregulation of external trade and payments arrangements, reductions in price and administrative controls and more reliance on market forces as a major determinant of economic activity.

Despite the adoption of the Structural Adjustment Programme, very little changed with respect to government fiscal policies. In his 1993 Budget speech, for instance, General Ibrahim Babangida explicitly admitted the failure of Government in the above regard. According to him:

> The lack of fiscal discipline is the bane of our economy. Inspite of realized revenues being above budgetary estimates, extra budgetary expenditure has been rising so fast and resulting in ever bigger deficit ….To say the least, this is a sobering revelation and we must all ensure that the deficit is not only minimized but eventually eliminated…. The practice of financing the fiscal deficit through the banking system, especially the Central Bank's Ways and Means facility, results in rapid growth of domestic liquidity, which in turn, exerts immense pressures on prices, interest rates and exchange rate of the Naira. As an illustration, between 1988 and 1991, an average of 77 percent of the overall deficit was financed by the CBN while in 1992 the deficit had been largely financed by the CBN. As a direct consequence, the monetary and credit aggregates have been exceeding prescribed targets in recent years.[25]

Such fiscal policy recklessness existed despite the fact that explicit regulations were put in place to limit the exposure of the CBN to the Federal Government through this Ways and Means mechanism. Specifically, section 33 of the Central Bank of Nigeria Act of 1991 stipulates that the Bank may grant temporary advances to the Federal Government in respect of temporary deficiency of budget revenue at such rate of interest as the bank may determine. The total amount of such advances outstanding shall not at any time exceed twelve and a half per cent of the estimated recurrent budget revenue of the Federal Government for the year in which the advances are granted. The section further stipulates that all advances made pursuant to this section shall be repaid as soon as possible and shall in any event be repayable by the end of the Federal Government financial year in which they are granted and if such advances remain unpaid at the end of the year, the power of the Bank to grant

[24] CBN Briefs (95/03, p.4).

[25] 1993 Budget, p. 12.

such further advances in any subsequent year shall not be exercisable, unless and until the outstanding advances have been repaid.

Unfortunately this important provision is rarely heeded and the CBN has continued to fund the Government fiscal deficits without any inhibitions advancing more than 50% of the budgeted revenue in some years. Okigbo, in his yet to be published 1994 investigation report on the CBN argued that on no account must the Governor either be made or be allowed to break the law. His report therefore proposed that the breach of this law should be a sufficient condition for removal of the Governor of the CBN.[26] But will such a provision help? Not necessarily. A government that flouts one law can flout another. In other words, the problem is not necessarily with the law but with its implementation. Just as easily as they are made, they can either be broken or revoked.

In addition to outrightly breaking the law in the above regard, the Government has also devised ways of getting around the law. In some cases, the Government simply securitizes these short-term debts thereby turning the entire principle of these CBN short-term credits on its head, with the same negative consequence for the economy. It has, for instance, rightly been noted that such CBN Ways and Means programme:

> Is an overdraft facility and should or cannot be used to finance Government deficits on a protracted basis. Also the historical practice of accumulating Ways and Means balances over the fiscal year, then converting the entire balance at year-end to treasury bills, is sub-optimal practice, since the market can almost never absorb such a large and sudden injection of funds into the system. This has had adverse ramifications for the Government's debt management programme as a whole. Also to the extent that accumulating Ways and Means balances until year-end before securitizing them and placing in the market, indicates that there is little planning taking place during the fiscal year, on how to finance the deficit… [The result is that] presently, 60 percent of the national debt is in the form of three months treasury bills, which are constantly rolled over. Most government borrowings however, is or should be for long maturity capital projects such as bridges or water projects. Obviously for such long term assets, borrowing over three months is a clear representation of a mismatched asset-liability portfolio.[27]

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[26] Newswatch, October 24 1994, p.32.

[27] Debt Management Office, 2003, p.4.

In such circumstances, government monetary policies have been of little positive consequence. Subsequent to the adoption of SAP for instance, the Government's major preoccupation with respect to Monetary policy has been curbing inflation in order to create a stable macroeconomic environment for sustainable development. In its bid to achieve the above, Government continued, at least for some time to use the instruments of sectoral allocation of credit. Government particularly continued to encourage loans to small-scale businesses and rural credits. In 1988, for instance, all banks were directed to increase the share of rural lending from 40 percent to 50 percent of the total deposits generated in the rural areas. It was however not until 1996 that the Central Bank abolished both the sectoral allocation of credits and the minimum lending to rural areas. The above policies were replaced by the policy of moral suasion, which essentially encouraged banks to continue to make credit available to these economic sectors. By 2002, the Central Bank had reversed itself and reestablished preferred lending to small and medium scale industries, re-christening it the Small and Medium Scale Industries Equity Investments Scheme (SMIEIS). Under this scheme, banks are required to set aside 10 percent of their profits before tax for investment in such small and medium scale businesses.

Perhaps the most fundamental change in the practice of post SAP monetary policy was the shift from a direct to an indirect monetary policy management system. The essence of this shift in Government policy was to strengthen and deepen the Nigerian money market with the aim of ensuring monetary stability in the economy. Prior to this shift in policy, as has already been mentioned, the function of underwriting of issues of treasury securities was undertaken by the CBN. This, for various reasons, usually resulted in high inflation. It has for instance been argued that:

> The performance of this function [underwriting treasury securities] has always tended to compound the difficulty inherent in monetary management, due to the large amount of treasury securities usually taken up by the CBN resulting in undue large credit to Government. This has made the control of the net domestic assets of the Bank problematic. The full impact of the excessive CBN credit to government on money supply is realized when government draws on the proceeds of the issues of treasury securities to finance its operations. The private economic agents which are being paid for the services rendered deposit their earnings in their accounts in their respective banks, thereby providing additional sources of credit creation to the banks. The larger the CBN's financial accommodation of Government, the greater the amount of high-powered money available to Government to inject into the economy and the more volatile the money supply.[28]

[28] Oduyemi (1992, p.84).

Mainly because of the above scenario, Government adopted various formulae in its bid to reduce the liquidity of banks with the aim of stabilizing the money supply. One remarkable one was its introduction of Stabilization Securities.[29] While such methods, at least to some extent, helped the Government to control the level of credit creation by the banks, they also threatened the very existence of some of the financial institutions. The only benefit of the system appeared to be the fact that it forced banks to increase their deposit drive especially with respect to currency usually outside the banking system. Along these lines, it has been argued that:

> As far as Stabilization Securities are concerned, however, banks continue to balk at the destabilizing effect this has had on their liquidity. Its involuntary nature, unpredictable size, lack of sensitivity to the liquidity of the existing asset structure of individual banks, are features that banks find unbearable. The liquidity squeeze resulting from this measure has caused a general rise in interest rates and a wide divergence in inter-bank interest rates paid or charged by the 'healthier' banks and those paid or charged by the illiquid banks. Interest rates on unsecured placements for the illiquid banks have been hovering around 100 percent per annum for the past 9 months. For banks heavily dependent on purchased funds (unsecured deposits, inter-bank or institutional) the threat of insolvency is substantial. The only redeeming feature of this approach is that it has increased the urgency with which banks are seeking out the burgeoning currency outside the banking system to attract it through deposit taking efforts into the system.[30]

There was thus the need to get the financial sector to participate more voluntarily in these securities. This meant a rethink of the entire operating environment for these financial institutions. This led to the adoption of the Open Market Operations by the Government.[31]

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[29] Banks were simply obliged to buy these securities without notice and on a basis that was not clearly defined.

[30] First Securities Discount House Report and Accounts (1993, p.5).

[31] "OMO, in its classical form, is conducted mainly in the secondary market for Government securities. Through the buying and selling of Government securities, the Central Bank directly changes the level of bank reserves and indirectly induces changes in the levels of interest rates, the terms and availability of credit and ultimately, the money supply. When the Central Bank sells securities in the market, the transaction leads initially to a contraction in the reserves that banks have available to meet their cash reserve requirements. The contraction in reserves leads in turn to higher interest rates and a contraction in bank credit and money supply. Conversely, when the Central Bank buys securities in the market, bank reserves increase and the ability to expand credit and money supply is enhanced" (Ojo, 1993, p.10).

The adoption of the OMO simply operationalised Government determination to drop the primary dealer concept and transfer the role of underwriting CBN treasury securities to commercial agents. Government subsequently opted for discount houses which is a specialized agency focusing mainly on this function.[32]

Since then, Government has continued to focus on this technique as the primary tool of monetary policy despite the realization that its success will fundamentally depend on prudent fiscal policies. According to the 2002/2003 monetary policy circular:

> The conduct of monetary policy will continue to rely on market-based technique in the management of CBN's balance sheet. The primary instrument of policy will continue to be Open Market Operations (OMO), supported by reserve requirements and discount window operations for enhanced effectiveness. The conduct of OMO will be proactive and will require the cooperation of the Federal Ministry of Finance to ensure consistency between monetary and fiscal policies as well as the stability of the financial markets… Open Market Operations… will be conducted weekly in the secondary market mainly in short-term government securities of varying maturities in order to meet the various preferences of participants in the market. OMO will be complemented by reserve requirements and discount window operations, including Repurchase Agreements (PEPOs) while discount houses will continue to play the role of principal dealers in the market.[33]

Thus far, however, the Government has been unable to reign in its deficits. This has negatively impacted on the effectiveness of the CBN's OMO policy.[34] From 1997 to 2003, for instance, the Government consistently ran deficits (table 1). This has, at least in part, been responsible for the unenviable and continuing increase of both the domestic and external debts of the country. In this regard, the country's total debts as a percentage of GDP, which stood at 32.85 percent in 1997, rose to 91.57 percent in 2003 (table 2). Another consequence of the perennial Government deficits is the high inflation rate which at least until recently has consistently led to negative real interest rates (table

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[32] "In dropping the Primary Dealer concept we are happy that the CBN has decided to undertake its Open Marker Operation exclusively through dedicated securities trading houses. Indeed we are confident of our ability to effectively carry the OMO actions to the market, given that our mission as a specialist in Treasury instrument trading will not be compromised by other business goals of FX trading, loans, and trade finance, mainly undertaken by banks (First Securities Discount House Report sand Accounts, 1993, pp.5-6).

[33] Monetary Policy Circular, 2002/2003, pp.9-10

[34] Uche, 2002, p.67.

3). A consequence of the unstable macro economic environment has been the consistent decline in industrial growth. Average manufacturing capacity utilization, for instance, which was 70.1percent in 1980, declined to 41.1 percent in 2003 (table 4).

Another cause of the declining local capacity utilization has been the fierce competition from foreign firms under the spirit of liberalization, which is a cardinal principle of SAP. Poor macro infrastructure, despite the huge oil rents the country has earned thus far has made it difficult for indigenous firms to compete globally. Most indigenous firms are required to make huge capital investments in basic infrastructure like roads, security, water and electricity. The result of such huge capital outlay is that indigenous firms are greatly disadvantaged when competing in a global world.

Admittedly, Government has, despite SAP sometimes imposed high tariffs on some imported goods and sometimes banned them out rightly. The utility value of such actions is however suspect. Without the necessary support infrastructure and condusive environment for sustainable economic development to take place, infant industry protection will be of little consequence.

Conclusion

A popular solution for putting an end to Nigeria's fiscal policy recklessness, which has been championed by World Bank Economists, is that what Nigeria needs is a fiscal policy rule, which would commit the government to a certain level of conduct in fiscal and budgetary management. Along these lines, it has been asserted that:

> Better management of the oil revenue cycle would have to be a central element of any effort to put Nigeria on a part of fiscal sustainability. Historically, fiscal policy in Nigeria has been extremely pro-cyclical with expenditures ratcheting out of control on the upswing of the oil price cycle. This has contributed to the observed deficit bias in the conduct of fiscal policy. One option is to put in place a fiscal policy rule. A fiscal policy rule makes sense in Nigeria, given the complete absence of a tradition of fiscal discipline. Because a fiscal rule commits government to a certain level of conduct in fiscal and budgetary management, it will help begin to build government credibility in fiscal management and over time, promote strong fiscal discipline across all tiers of government. A rule, based on oil prices, will also help address the issue of the vulnerability of all tiers of government to oil price swings and reduce the pro-cyclicality in the budget. This will allow savings to build up financial assets in periods with high oil

prices that can be used to finance the desired expenditure programmes when oil prices are low.[35]

There is however no guarantee that rules will work in Nigeria. Subsequent Governments have had no respect for rules, be it monetary or fiscal policy rules. Take for instance the already mentioned regulation, which limits the amount of credit a central bank is allowed to advance to government. A Government that flouts one rule can easily flout another. Finding a solution to this problem is therefore much more complex. Specifically there will be little progress towards fiscal prudence until some powerful pro-stability stakeholders strong enough to challenge government fiscal recklessness emerge. The people, if and when provided with a proper democratic structure, have the potentials of constituting such an interest group. Under such a scenario, elections could be used to get rid of pro-inflation governments. Financial institutions also constitute another pro stability interest group. Unfortunately, the indigenization exercise of the 1970s severely decimated the powers of this group. With majority Government ownership of the main banks, it became difficult to differentiate between the views of government and the views of the bank. The new N25 billion bank capitalization requirement by the CBN, despite its flaws may well turn out to have some unintended positive side. Mega banks will no doubt be in a much stronger position to make the point that Government's reckless fiscal policy and its attendant macroeconomic instability is the main cause of financial instability. Until the fiscal recklessness of the Government is checked, the use of monetary policies to achieve macroeconomic stability will remain nothing more than an illusion.

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[35] Kwakwa, 2003, p.65.

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Table 1: Government Revenue, Expenditure and Fiscal Deficit As Percentage of GDP

Year	Retained Revenue	Total Expenditure	Overall Deficit/Surplus
1980	25.55	29.44	-3.88
1981	14.80	22.49	-7.69
1982	11.24	23.02	-11.79
1983	11.05	16.98	-5.93
1984	11.52	15.74	-4.22
1985	13.96	18.21	-4.24
1986	10.95	22.29	-11.34
1987	14.64	19.98	-5.35
1988	10.74	19.11	-8.38
1989	11.64	18.44	-6.80
1990	13.89	21.94	-8.05
1991	9.62	20.78	-11.16
1992	9.83	17.13	-7.30
1993	12.04	27.57	-15.53
1994	9.98	17.72	-7.74
1995	12.80	12.75	0.05
1996	13.25	12.10	1.15
1997	14.56	14.73	-0.17
1998	12.47	17.17	-4.70
1999	19.26	27.55	-8.29
2000	12.27	14.41	-2.13
2001	14.42	18.42	-4.00
2002	11.20	15.91	-4.71
2003	16.36	19.60	-3.24

Sources: Central Bank of Nigeria (CBN) Statistical Bulletin, 2003

Table 2: Nigeria: Domestic and External Debt As % of GDP (1980-2003)

Year	Domestic Debt/GDP	External Debt/GDP	Total Debt/GDP
1980	16.19	3.67	19.86
1981	22.06	4.59	26.65
1982	28.98	17.03	46.01
1983	39.17	18.64	57.81
1984	40.70	23.48	64.18
1985	39.03	24.16	63.18
1986	39.07	56.95	96.02
1987	33.39	91.47	124.86
1988	32.39	92.27	124.66
1989	21.14	108.02	129.17
1990	30.62	108.72	139.33
1991	36.26	102.50	138.77
1992	29.88	100.46	130.34
1993	37.64	91.28	128.92
1994	28.57	71.46	100.03
1995	12.75	36.73	49.47
1996	12.33	22.15	34.48
1997	12.35	20.50	32.85
1998	18.95	22.31	41.26
1999	23.10	74.92	98.02
2000	18.46	64.33	82.78
2001	18.40	57.48	75.88
2002	18.22	61.46	79.68
2003	21.26	70.31	91.57

Source: Central Bank of Nigeria (CBN) Statistical Bulletin, 2003

Table 3: Nigeria: Nominal and Real Interest Rates and Rates of Inflation (1970-2004)

Year	Nominal Lending Rate	Inflation Rate	Real Interest Rates
1970	7.5-8.0	13.8	-6.3
1971	10.00	16	-6.00
1972	10.00	3.2	6.80
1973	10.00	5.4	4.60
1974	10.00	13.4	-3.40
1975	9.00	33.9	-24.90
1976	10.00	21.2	-11.20
1977	6.00	15.4	-9.40
1978	11.00	16.6	-5.60
1979	11.00	11.8	-0.80
1980	9.50	9.9	-0.40
1981	10.00	20.9	-10.90
1982	11.75	7.7	4.05
1983	11.50	23.2	-11.70
1984	13.00	39.6	-26.60
1985	11.75	5.5	6.25
1986	12.00	5.4	6.60
1987	19.20	10.2	9.00
1988	17.60	38.3	-20.70
1989	21.60	40.9	-19.30
1990	26.50	7.5	19.00
1991	20.80	13	7.80
1992	25.70	44.5	-18.80
1993	36.20	57.2	-21.00
1994	20.80	57	-36.20
1995	20.80	72.8	-52.00
1996	26.40	29.3	-2.90
1997	20.30	8.5	11.80
1998	21.80	10	11.80
1999	22.50	6.6	15.90
2000	26.40	6.9	19.50
2001	31.20	18.9	12.30
2002	25.70	12.9	12.80
2003	21.60	14	7.60

Sources: Ekpo, A. H., 2003, p.11 and CBN Statistical Bulletin 2003.

Tables 4: Nigeria: Average Manufacturing Capacity Utilization Rates (1975-2003) in %

Year	Capacity Utilization
1975	76.6
1976	77.4
1977	78.7
1978	72.9
1979	71.5
1980	70.1
1981	73.3
1982	63.6
1983	49.7
1984	43
1985	38.3
1986	38.8
1987	40.4
1988	42.4
1989	43.8
1990	40.3
1991	42
1992	38.1
1993	37.2
1994	30.4
1995	29.3
1996	32.5
1997	30.4
1998	32.4
1999	34.6
2000	36.1
2001	42.7
2002	44.3
2003	41.1

Source: Central Bank of Nigeria (CBN) Statistical Bulletin, 2003