CHAPTER ONE

INTRODUCTION

THE NIGERIAN ECONOMY: AN OVERVIEW

1.01 For all its vaunted wealth of mineral resources and the highly visible and vocal manufacturing sector, the Nigerian economy is still' basically agricultural, dominated for the most part by peasant small holder farms. At independence in 1960, the proportion of the Gross Domestic Product accounted for by agriculture (defined broadly to include crops, animal husbandry, fishing and forestry) and petroleum stood at 67.0 per cent and 0.6 per cent respectively; by 1974 the proportions had been reversed to 23.4 and 45.5 per cent respectively. In 1984, the shares of agriculture and petroleum went down further to 15.5 per cent and 28.0 Per cent respectively. The contribution of manufacturing and government has doubled in the period 1960 to 1984 although to a still relatively low level of 11.0 per cent arid 7.0 Per cent respectively. As at the end of 1993, the share of agriculture (at 1984 factor cost) had climbed up once again to 38.10 Per cent of GDP with petroleum oil going down to 12.66 from the 13.47 Per cent in 1992; the share of manufacturing had stabilised since 1988 at around 8 to 9 per cent (See Tables 1.1 and 1.2).

1.02 Although petroleum continues to dominate the public finances and foreign exchange resources of Nigeria, the sector is, in reality, an enclave economy employing less that 100,000 Nigerians directly in production. Outside of transportation and, perhaps, a small section of the industrial sector, the petroleum economy has very little linkage with Nigerian production.. ft buys little or nothing from the manufacturing or agricultural sector, transfers little or no technology to either agriculture or manufacturing. Agriculture, on the other hand, together with trade provides the bulk of the employment for Nigerians, provides the bulk of the needs of the household sector but supplies only a small part of the needs of manufacturing. in a similar vein, until recently when it began to make use of locally made fertilizers and pesticides, it bought very little from manufacturing. Iii effect, the three main sectors — agriculture, manufacturing and mining — have no interlinkages in production and each therefore operates almost. like an island unto itself.

TABLE 1.1 – GROSS DOMESTIC PRODUCT AT 1984 FACTOR COST

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TABLE 1.2 - GROS DOMESTIC PRODUCT AT CURRENT MARKET PRICES

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1.03 The oil boom of the 1970's and early 1980's raised the consumption levels of both domestic and foreign goods. It led to the neglect of agriculture and to the increasing import dependence of the manufacturing sector; with capital goods production accounting for less than 15 per cent of total manufacturing output, Nigeria has had to depend on imports not only for equipment and machinery and for intermediate goods and raw materials but even for food. The sudden decline in oil prices in the mid 1980's, which has persisted to date, the near insatiable demand for imports and the weakening of the supply base have combined to generate severe internal pressures and external disequilibria. In addition, time governments, at both federal and state level, have shown themselves unable to reduce the size and scope of their expenditures and budget deficit.

1.04 The Obasanjo regime (1976 - 1979) had bequeathed to the incoming Shagari government, in October 1979, an external debt of $6.8 billion; by the end of the Shagari administration in December 1983, the stock of external debt stood at $18.5 billion. The succeeding Buhari government pushed it up further to $21.2 billion by 1985. The debt burden measured by the ratio of debt service to export proceeds stood at 20.4 per cent in 1978, 15.4 per cent in 1980, 30' per cent in 1981 and 61.5 per cent in 1982. It was rising to hit 107 per cent in 1983/84. With the population assumed to be growing at 2.5 per cent per annum and debt service running at some 4 per cent of the Gross Domestic Product, it means that just to maintain the living standards of time people at a stand still, the economy would be required to grow at a minimum of 6.5 per cent per annum on a sustainable basis.

1.05 The balance on external account showed a small deficit for most of the period between 1960 and 1970; it then recorded a very large surplus in 1973 and 1974. Within two years, the government of General Gowon (1966 - 1975) nearly succeeded in wiping out this surplus in short order; three years later, by 1978, the account had turned to a large deficit of $3.696 billion. By deferring the external obligations through a readily recognisable financial screen, General Obasanjo left a surplus of $5.870 billion in 1979/80. By 1981, time Shagari administration had turned the tables into a deficit of $5.3 billion thereby creating time environment for an austerity package in 1982. But these were shortlived. It took General Buhari's draconian measures in 1984 to reverse the tide to a modest surplus in 1984. However, by 1985, it was rapidly becoming clear that the accumulation of innumerable regulations administered by innumerable persons had literally brought the economy to a standstill.

1.06 The Babangida administration that swept itself into office in August 1985 was quick to recognise this dilemma. After an extensive, even if ill-informed, public debate on IMF supported model of structural adjustment, the government introduced what it ostensibly regarded as its own home-grown programme of structural adjustment. The year 1986, therefore, marked the beginning of economic deregulation with the objectives of:

a) restructuring and diversifying the economic base of the economy and reducing the dependence on oil;

b) achieving fiscal balance and reducing ~he deficit in the balance of payments in the medium term;

c) laying the foundation for non inflationary growth in the medium and long term.

1.07 The thrust of the measures for deregulation was to promote competition and efficiency through greater reliance on market forces. These encompassed the following:

a) The abolition of import licensing in September, 1986;

b) The partial removal of exchange controls in September 1986, reduction of government borrowing, and strengthening the use of Treasury Bills as an effective tool of monetary control;

c) The removal of restrictions on commercial banks to engage in equipment leasing and relaxation of restrictions on equity participation in companies by banks; and

d) The adoption of indirect tools of monetary control (that is, the use of cash reserve requirements, liquidity ratios, the discount rate and Open Market Operations) and the establishment of discount houses.

1.08 The reform of the banking system was undertaken in part to strengthen and enhance the performance of the supervisory and regulatory framework and in part to improve the reliance of the banking industry on market forces. Among these reforms were the granting of autonomy to the Central Bank, the promulgation of the Central Bank of Nigeria and the Banks and Other Financial Institutions Decrees in 1991, the establishment of the Nigeria Deposit

Insurance Corporation, and the issuance of prudential guidelines and regulations by the Centra1 Bank to the banking institutions.

1986 AND AFTER

1.09 The decade before the Babangida regime, that is the administration of Obasanjo, Shagari and Buhari, was an age of prohibitions in which the economy was almost being choked to death by controls. The Babangida era was, on the other hand, an age of transition; it dismantled the controls exercised on the economy by politicians and bureaucrats for over four decades. The gains were most impressive and noticeable in the first three years of structural adjustment; thereafter the profligacy of government spending and the nature of its financing from 1990 to 1993 wiped out the progress already made. The following achievements of the first three years of the Structural Adjustment Programme (SAP) must, however, be recorded:

a) on the External Sector, the Current Account deficit fell to $2.1 billion in 1986, and to only $73 million in 1987 turning into a surplus of $1.1 billion in 1989, $5.2 billion in 1990 but down to $1.3 billion in 1991 and $748 million in 1993;

b) External Debt service that stood at 23.4 per cent in 1986, climbed to 30.2 per cent in 1988 but had to be held down by public policy to 27.5 per cent in 1989; it jumped to 40 per cent in 1990, threatened to hit 61 per cent in 1992 and 29.3 per cent and 30.1 per cent in 1993 and 1994, respectively;

c) public expenditure remained restrained until 1988; thereafter it became reckless with budget deficit representing some 8.8, 9.2, and 12.6 per cent respectively of the Gross Domestic Product in the three years 1989 - 1991 and 10.1 and 12.3 per cent respectively in 1992 and 1993. Concomitantly, money supply (Ml) rose by 17.1 per cent in 1987, 24.8 per cent in 1988 and on the average, by 41.5 per cent between 1988 and 1991; it rose further by 66.4 per cent in 1992 and 54.6 per cent in 1993. Broad money (M2) grew by an average of 28 per cent between 1988 ad 1991, and rose by 57 per cent between 1991 and 1992 and by 52.8 per cent between 1992 and 1993;

d) the Consumer Price Index, measuring the movement in the genera1 price level with 1985 as base, rose to only 181.2 in 1988, but had jumped to 330.9 in 1991, 478.4 in 1992 and 751.9 per cent in 1993 (Table 1.3). The acute inflation represented by these numbers is compounded by the growing unemployment which had changed qualitatively since the '70's: in the '70's the bulk of the unemployed had completed only up to primary school level and took some six weeks for job search, but by the mid '80's the bulk of the unemployed had completed their University education and took some two years or over to find a job; and

e) by 1988, industrial capacity utilisation stood at only 41.7 per cent; it fell to 37.6 percent in 1989 and further to 38.2 in 1991; for 1993 it is put by the Manufacturers Association of' Nigeria at under 30 per cent. In effect, Nigeria is moving from the non-industrialisation of the colonial and immediate post colonial era to a period of de-industrialisation.

1.10 The incessant increase in the demand for foreign exchange, caused by the high level of liquidity in the system as a result of excess government spending, and the dwindling level of export earnings caused by fall in oil prices and the stagnation of non-oil export, resulted in a 16% average annual depreciation in the Naira. Such persistent and precipitous depreciation, however, failed to induce any significant increase in non-oil export as was pontificated when SAP was introduced. Efforts to stem the surging demand. for foreign exchange, through monetary contraction, failed to have a lasting effect and to prevent the widening of the gap between the official and parallel market rates. In February 1993 a new rule was introduced, in which each bank's allocated share of foreign exchange was made proportional to its holding of Naira deposits at the Central Bank of Nigeria. That arrangement caused a withdrawal of virtually all excess liquidity from the financial system for most of the time. When all efforts to stabilise the foreign exchange rate failed, the present government, in 1994, fixed the rate at about N22.00 to $1.00 and re-introduced exchange controls and the direct allocation of foreign exchange to priority sectors.

1.11 The deregulation of interest rates in 1991 engendered very keen competition in the banking industry, with banks adopting new strategies to attract deposits and encourage savings. However, the rapid and significant shifts in interest rates were causes for serious concern because such high rates

TABLE 1.3 – COMPOSITE CONSUMER PRICE INDEX 1985 – 1983

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could and did retard productive investment and growth. The Central Bank was obliged to modify policy of total deregulation of interest rates, and to request banks to justify their interest rates by reference to their actual cost of funds. In 1994, the authorities felt that the prevailing interest rate levels were out of equilibrium and counter—productive and re—introduced interest rate ceilings of a maximum of 15 per cent for deposit l a maximum of 21 per cent for lending.

THE DEVELOPMENTS IN THE NIGERIAN FINANCIAL SYSTEM

1.12 The Nigerian financial system, of which the Central Bank of Nigeria (CBN) is the apex, has undergone remarkable changes in terms of ownership structure of its institutions, the depth and breadth of instruments employed, the number of institutions established, the economic environment amid the regulatory framework within which the system operates. Following thee Region introduced under the SAP, the system became more market—oriented and the banking sector witnessed a remarkable-growth between 1987 and 1991. As Table 1.4 shows, the total number of commercial and merchant banks rose from 29 amid 1 2 in 1986 to 66 and 54 respectively in December, 1991, after which the issuance of new license was suspended. (The licenses of two banks have been revoked in 1994 bringing the number down to 118). Similarly, the number of bank branches rose from 1494 in 1986 to 2,364 as at the end of 1993. The number of other financial institutions also increased and new specialized banks were set up. There are now 7 development banks, 879 Community Banks, over 1,000 finance companies, 252 mortgage institutions, and many other non—bank financial institutions. Other institutions such as Bureaux de Change, the Peop1e’s Bank and stockbroking firms have also grown tremendously. The growth in the volume of activities and in the variety of products of these institutions has no doubt been beneficial to time economy. At the very least, the increased competition, engendered by the expansion in the number of institutions, had, in some respects, meant greater customer satisfaction.

PRIMARY OPERATORS

1.1.3 The primary operators in the financial system are in seven (7) major groups namely:

a)Licensed banks — commercial and merchant banks