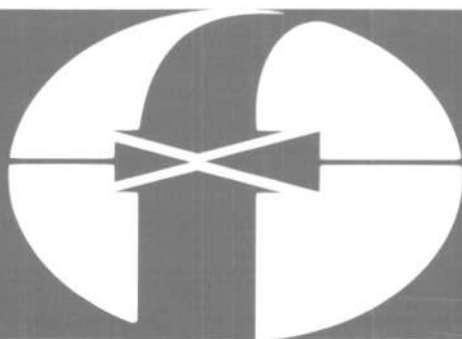


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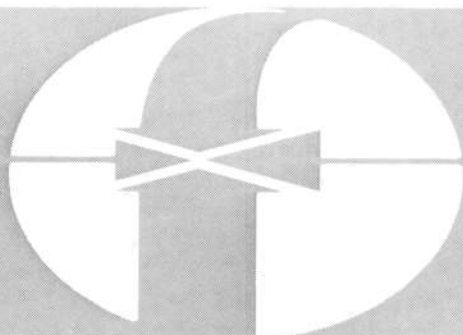
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Contents

MANAGING THE NIGERIAN ECONOMY UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME (SAP), MONETARY POLICIES AND THE SECOND TIER FOREIGN EXCHANGE MARKET-SFEM <i>by G.O. Nwankwo</i>	207
CAUSAL DIRECTIONS IN THE RELATIONSHIP BETWEEN DOMESTIC CREDIT AND CHANGES IN NET FOREIGN RESERVES IN KENYA <i>by F.M. Mwega, S.M. Ngola</i>	221
THE MORGAN-MEXICO AND AFRICAN DEVELOPMENT BANK PLANS AND THE PROBLEM OF SUB-SAHARAN AFRICAN DEBT <i>by Robert H. Wessel</i>	235
THE INTEREST RATE STRUCTURE AND FACTORS AFFECTING INTEREST RATE DETERMINATION IN THE INFORMAL RURAL CREDIT MARKET IN SRI LANKA <i>by Nimal A. Fernando</i>	249
DEMAND FOR MORTGAGE FINANCE IN NIGERIA: A CROSS-SECTIONAL ANALYSIS <i>by Roland E. Ubogu</i>	271
BRDB CREDIT UTILIZATION: EVIDENCE FROM THE RURAL POOR PROGRAM <i>by M. Kabir, M. Moslehuddin, G.K. Bose</i>	287

Sommaire

UNE POLITIQUE ÉCONOMIQUE POUR LE NIGÉRIA DANS LE CONTEXTE D'UN PROGRAMME D'AJUSTEMENT STRUCTUREL: POLITIQUES MONÉTAIRES ET DOUBLE MARCHÉ DES CHANGES <i>par G.O. Nwankwo</i>	207
EXPANSION DU CRÉDIT ET RÉSERVES DE CHANGE AU KÉNYA: UNE ANALYSE DES RAPPORTS RÉCIPROQUES <i>par F.M. Mwega, S.M. Ngola</i>	221
LE PLAN MORGAN-MEXIQUE ET LE PLAN DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT: CONSIDÉRATIONS SUR LE PROBLÈME DE LA DETTE DES PAYS DE L'AFRIQUE SUB-SAHARIENNE <i>par Robert H. Wessel</i>	235
LA STRUCTURE DES TAUX D'INTÉRÊT ET D'AUTRES FACTEURS DÉTERMINANT LE TAUX D'INTÉRÊT DANS LE MARCHÉ INFORMEL DU CRÉDIT RURAL AU SRI LANKA <i>par Nimal A. Fernando</i>	249
LA DEMANDE DE CRÉDITS HYPOTHÉCAIRES AU NIGÉRIA: UNE ANALYSE ÉCONOMÉTRIQUE (CROSS-SECTIONAL ANALYSIS) <i>par Roland E. Ubogu</i>	271
L'UTILISATION DU CRÉDIT DU BUREAU DE DÉVELOPPEMENT RURAL DU BANGLADESH: L'EXPÉRIENCE DANS LE CADRE DU PROGRAMME POUR LES PAUVRES RURAUX <i>par M. Kabir, M. Mouslehuddin, G.K. Bose</i>	287

MANAGING THE NIGERIAN ECONOMY UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME (SAP), MONETARY POLICIES AND THE SECOND TIER FOREIGN EXCHANGE MARKET - SFEM*

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University of Lagos

1. Introduction

The Structural Adjustment Programme (SAP), the current Monetary Policies and the Second Tier Foreign Exchange Market (SFEM) were adopted to redress Nigeria's economic malaise resulting from the previous mismanagement of the economy. Although these measures have been in operation for a little less than a year, it is necessary to examine the management of the economy under the new measures. To do so effectively, it is appropriate to highlight some of the malaise of the economy and the mismanagement that resulted in the malaise. This is done in Section 2 of this paper. In Section 3, the highlights of SAP, the current Monetary Policy and SFEM will be indicated. Section 4 attempts an assessment while Section 5 sets out the main conclusions.

2. The Malaise of the Nigerian Economy

The malaise of an economy usually manifests in adverse movements in key economic indicators: gross domestic product, price level, industrial and agricultural production, unemployment, balance of payments, exchange rates and domestic and external debt, etc. These adverse movements translate into difficulties which are experienced and felt by all sectors or classes of the economy. For those in business, be they in industry, commerce or services, there is shortage of inputs or sluggish demand, dull business climate and uncertain future business outlook. Rising prices in the market put commodities progressively out of the reach of consumers. Government experiences declining revenues and pile up of debt, both domestic and external; while the level of public services¹ — medical services, roads and other infrastructural services — deteriorate. Unemployment increases and job seekers, both skilled and unskilled, find it increasingly difficult to find jobs.

The above manifestations of economic sickness have characterised the Nigerian economy, particularly since 1981. At 1977/78 constant factor cost, GDP rose by 2.9 percent to N30325.2m in 1980. Thereafter it declined persistently by 2.8% in 1981, 1.9%

* The text of a lecture delivered to *Development Course* of the Senior Staff of the Societe Generale Bank, (Nigeria) Ltd.

¹ E.E. Ogbe: (Director of Research Central Bank of Nigeria): *The Nigerian Economic Malaise: Diagnosis, Prognosis and Management* — Paper presented at Alumni Symposium, Bayero University, Kano 16 January 1977.

in 1982 and 6.4% in 1983. Although there was a slight increase of 5.6% in 1985, it nevertheless declined again by 3.4% in 1986! These persistent decline were occasioned in the main by the glut in the international oil market. Given the heavy dependences of the country on oil as a source of foreign exchange (about 90%) as well as the bulk of Government revenue (85%) the glut inevitably adversely affected developments in all the sectors of the economy.

Government revenue was probably the first to be hit. The drop in price and production of crude oil resulted in a fall of about 44% in projected foreign exchange earnings². Realised revenue fell short of budget estimates and this created cash flow problems for the government. An attempt to maintain the level of government expenditure led to unacceptably huge budget deficits both at the Federal and State levels. On the other hand attempts to exercise restraint resulted in the suspension and abandonment of many government projects. The reduction in foreign exchange earnings led to a fall in the level of imports and the failure to meet some external debt obligations. Attempts to open fresh lines of credit or to reschedule external debt obligations stalled on the demand by external creditors that the country should reach an understanding with the IMF and devalue its currency in order to establish a realistic exchange rate for the naira. The oil glut also brought the external payments position under severe pressures. Owing to fortuitous circumstances resulting from the Iranian revolution, external transactions resulted in a surplus of N2406.2m in 1980 but this turned into a deficit of N3036.8m in 1981. These deficits persisted since then despite the small surpluses of N354.8m and N561.6m in 1984 and 1985 due to the fact that a number of external obligations were unhonoured, including, particularly, a lot of import bills which were left unpaid. This resulted in a lot of backlog of trade debt arrears with which the nation is still battling.

From being the backbone of the economy, agricultural production declined drastically, its share of the GDP having fallen rapidly from around 40% in the early 1970s to 20% in 1980. This decline was due to a number of factors-migration of farm labour to the cities during the oil boom to take advantage of job opportunities and higher remunerations, bad weather, high incidence of pest and disease infestations, inadequate supply of critical inputs such as fertilisers and pesticides, lack of storage and preservation facilities and inadequate infrastructural facilities, particularly in the rural areas.

2 1987 Federal Government Budget and Prospects for Economic Recovery in Nigeria being text of an address delivered by the Governor of the Central Bank of Nigeria at the inaugural launching of Kano Public Lecture series at the Bayero University, Kano on 18th February 1987 p. 2.

Industrial production also persistently declined, recording an average annual decline of 3.4% during 1981-86. The import substitution industrial strategy adopted during the oil boom years could not be sustained as the imports of factor inputs fell when overseas suppliers refused to accomodate further credit to Nigeria. Consequently, capacity utilisation in the manufacturing sector dropped persistently from 75.1% in 1980 to 34.6% in 1985 and 29% by the second half of 1986³.

The decline in industrial capacity utilisation, the cut down on government expenditures, and the abandonment of government projects including non payment of money to private contractors worsened the unemployment situation. This was aggravated by the expansion of educational facilities which swelled the number of unemployed school leavers and college graduates. Job opportunities thinned down considerably owing to slow down in new investments and the closure of factories which resulted in mass retrenchment of workers in the private sector. Government itself embargoed new employments in 1981 and subsequently retrenched many workers. All these added to the high unemployment situation with which the nation is still battling.

To the above is added the spiralling inflation which emanated principally from inadequate supply of goods and services, high transport costs and distribution bottlenecks. Apart from 1982 and 1985 when food production received a boost and government measures succeeded in restraining aggregate demand, price inflation fluctuated between 20.9% in 1981 and 39.6% in 1984.

There is finally the impact of policy measures adopted from 1981 to 1985 to address the above problems. These included the Economic Stabilisation Act of 1982 involving stringent monetary, fiscal and exchange control measures, the placing of all imports under specific import licence in 1984, the suspension and abandonment of some public works projects as a result of the revenue shortfalls, the commencement of external debt rescheduling arrangements and declaration in October 1985 of 15 months Economic Emergency period, including some fiscal measures to boost revenue.

The above measures had limited impact in solving the problems. Exchange controls in particular encouraged and promoted various malpractices. These included over-invoicing of imports to side-track exchange restrictions and thereby transfer money illegally abroad; refusal to surrender foreign exchange proceeds of exports by private exporters, smuggling in various forms, illegal dealings in foreign exchange in the parallel

3 Ibid to 3.

or black market and corruption of officers supposed to administer and enforce the various control measures.

They were also restrained by the continued fall in foreign exchange revenue, the over valuation of the naira and other distortions and rigidities in the economy. Above all they were largely demand management strategies and as such merely served as palliatives. They could not get to the root of the problems which were structural in nature. In the circumstance it became increasingly clear that only a properly articulated structural adjustment programme can really put the economy back on the path of sustained economic recovery.

3. The Highlights of the Structural Adjustment Programme, SFEM and Current Monetary Policy

The SAP is a revision and consolidation, in a more comprehensive form, of the far reaching economic policies enumerated in the 1986 Budget⁴. Announced in June 1986 and covering a two year period, July 1986 - June 1988, SAP sets out Governments strategy for addressing the continuing crisis in the economy. The essence of the strategy is the restoration in the medium term of a healthier path of national economic development as a component of an integrated world economy⁵.

SAP aims at altering and realigning aggregate domestic expenditure and production patterns of the economy so as to minimise dependence on imports, enhance the non-oil export base and bring the economy back on the path of steady and balanced growth. More specifically the objectives are

- (i) to restructure and diversify the productive base of the economy in order to reduce dependence on the oil sector and on imports;
- (ii) to achieve fiscal and balance of payments viability over the period.
- (iii) to lay the basis for a sustainable non inflationary or minimal inflationary growth.
- (iv) to lessen the dominance of unproductive investments in the public sector, improve the sector's efficiency and intensify the growth potential of the private sector.

4 G.O. Nwankwo: A critique of the 1986 Budget — being paper presented at the Nigerian Economic Society (Kaduna Chapter).

5 Federal Republic of Nigeria: Structural Adjustment Programme July 1986 — June 1988 p. 3.

The main elements of the programme are:

- (1) Strengthening of the hitherto strong demand management policies.
- (2) Adoption of measures to stimulate domestic production and broaden the supply base of the economy.
- (3) Adoption of a realistic exchange rate policy.
- (4) Further rationalisation and restructuring of the tariffs in order to aid the promotion of industrial diversification.
- (5) Move towards improved trade and payments liberalisation.
- (6) Reduction of complex administrative controls simultaneously with a greater reliance on market forces.
- (7) Adoption of appropriate pricing policies especially for petroleum products and public enterprises and finally,
- (8) Encouragement to rationalisation and privatisation of public sector enterprises⁶.

The objectives and strategies of SAP were carried further in the 1987 Budget whose operational terms are «consolidation and growth». As a matter of fact, the 1987 budgetary proposals were designed to consolidate the progress made so far on the implementation of SAP as well as to promote economic growth. In the process the budget explicitly acknowledged that most of the problems identified in the 1986 budget remained largely unsolved.

To this end, the Budget underlined eleven basic policy strategies for its implementation. These are as follows:

- (1) Pegging debt service ratio to 21.6 percent of export earnings in 1987 in line with the agreement reached on a comprehensive rescheduling of external debt.
- (2) Continued prominence to be accorded to food and rural development in order to move the nation rapidly towards self reliance and self sufficiency in the production of basic staples of grain, tuber, vegetable oil and fibre.
- (3) Encouragement for increased use of local materials by entrepreneurs, industrials etc.
- (4) Employment generation schemes particularly for youths and college graduates.
- (5) Encouragement and sustenance of a general national culture of maintenance and repairs.
- (6) Greater industrial capacity utilisation by making use of local materials to supplement imported inputs and exploration of export market potentials.

⁶ Ibid to 9.

-
- (7) Continued restraint in spending in order to mobilise domestic savings for investment.
 - (8) Tax relief for workers to enhance disposable income.
 - (9) Promotion of industrial peace through management and worker reconciliation of industrial disputes.
 - (10) Acceleration of Nigerianisation of top management in the private sector.
 - (11) A comprehensive review of tariff measures in line with the new exchange rate system⁷.

The Second Tier Foreign Exchange Market

Among the core policies of SAP are actions to correct the serious overvaluation of the naira; and the instrument for this is the SFEM which came into operation on September 29, 1986. It constitutes a major element of SAP, the objective being to evolve a realistic market determined naira exchange rate so as to reduce the demand for foreign exchange to available supply, reduce the pressures on the balance of payments and stop further accumulation of trade debt. It is expected that such a realistic exchange rate will eliminate existing distortions in the economy, reduce imports, stimulate exports, and pave the way to a self-reliant and sustainable growth. Adjustments of the first tier rate would also be made and aimed at convergence of the various rates as soon as possible.

Monetary Policy

SFEM and other SAP measures were supplemented with a fiscal policy that is expansive in some respects and a stringent monetary policy. While the objective in the expansive fiscal policy is to generate employment and increase productive activities, the objective in the tight monetary policy is to contain the attendant inflationary pressures in the implementation of SAP and SFEM. Accordingly the thrust of monetary policy was geared to the maintenance of internal and external equilibrium. More specifically the objectives of monetary and credit policy in 1987 are to:

Moderate the inflationary pressures that could arise from the operation of the SFEM, stimulate domestic financial savings and efficient resource allocation, encourage foreign capital inflow and increased export earnings from non oil sources, stimulate local production of goods and services and ensure an improvement in the balance of payments⁸.

⁷ The 1987.

⁸ Central Bank of Nigeria: Guidelines for the 1987 Fiscal Year: Monetary Policy Circular No. 21 p. 3.

The policy was formulated with conscious efforts made to gradually dismantle the controls which formed the basis of past economic policies and which had encouraged corruption, price distortions and inefficiency in the economy generally. Accordingly the 18 sector/subsector categorisation which had been compressed into 8 in 1984 and 1985 and into 4 in 1986 was further contracted into 2 in the 1987 Monetary policy guidelines. Interest rate policy was also liberalised with minimum deposit and maximum lending rates fixed while banks were free to negotiate rates within these limits. Finally in order to ensure that sectors that can contribute most effectively to the expected recovery in the economy are not starved of credit, banks were enjoined to ensure that no deserving application for agricultural production and marketing, manufacturing for export and export financing is rejected on the ground that the specified credit ceiling is reached or will be exceeded.

4. An Interim Assessment

An interim assessment of SAP may now be undertaken. This involves an examination of the extent to which SAP has effectively addressed the basic policy issues such as:

- (a) Changing national orientation and attitude to doing things;
- (b) reducing the heavy dependence on oil, on government and on imports as prime movers of the economy;
- (c) improving agricultural production;
- (d) decontrol and move towards free market mechanism and
- (e) the effects of all these on key economic targets of economic policy such as growth in the GDP, employment, price stability, and balance of payments.

In terms of changing the national orientation, and the way we see and do things, there is no doubt that SAP and its key policy frame - SFEM - have already begun to effect changes in the national psychic. The immediate abolition of import licensing and the rigid exchange control regulations on all current transactions, the reduction of prohibited import items from 74 to 16, the incentives to promote non oil exports, the rationalisation of custom tariffs, and SFEM, are all examples of SAP measures that are already changing the nation's attitude to doing things.

Policy measures to address the reduction of heavy dependence on oil include export promotion incentives geared towards diversification of foreign exchange earnings. Exporters, apart from enjoying a 100 percent withholding of export earnings, also enjoy a refund of all import charges within eighteen months from the importation of the in-

puts. In addition, as the Governor of the Central Bank pointed out, «steps will be taken to export gas in embodied form during the year while the first phase of the petrochemical project, by now virtually completed, will be commissioned by Government⁹.

Reduction of the heavy reliance on Government is addressed in the SAP measures by the reduction in budget deficits, disbandment of the commodity boards, reduction of the River Basin Development authorities from eighteen to eleven and the decision to wind up eleven Government companies involved in direct agricultural production activities, and their transfer to the private sector. Others include an industrial strategy that deemphasises public sector dominated large capital intensive projects in favour of the provision of the necessary macro economic environment, and other incentives for private sector lead and initiative.

Apart from the tax relief for private sector investment in the area, a number of institutions are planned under the programme to address the issues of low production in agriculture and wastage of farm produce due to non processing and absence of preservation facilities. These institutions include a National Security and Storage System for farm and off farm storage; a National Small Scale Farms Credit Programme to bring seasonal credit to farmers for both preproduction and post harvest, and a Food Market Information Dissemination Service to provide information on inventories and stocks, market trends, spot and future prices etc.

Decontrol and movement towards more reliance in free market force is inherent in the SFEM, the abolition of import licences and of rigid exchange controls and the reduction in the categorisation of the economy into sectors/subsectors for the purposes of credit allocation from 18 to 8 in 1984 and 1985 to 4 in 1986 and 2 in 1987. This is designed to allow the banks greater flexibility, initiative and innovation in their operations. An element of deregulation is also evident in the interest rate policy for 1987 in which only the maximum lending rate and the minimum deposit rates have been fixed, allowing banks freedom to negotiate appropriate deposit and lending rates with their customers within the margin.

Another economic malaise which SAP tries to address is mounting unemployment. For this purpose a Directorate of Employment is established and funded with N100m. In addition a technical Aid Corps Scheme is proposed to export professionals to «assist African countries which regularly request for Nigerian personnel in specific fields». Other

9 Ogbe op. cit.

measures include the reactivation of public works, the use of direct labour by the various tiers of government for repair and maintenance of public projects and access of credit for the self employed.

Having indicated how SAP addressed some of the key policy issues in the economy, a few comments may be made on impact or probable impact of the measures on some key economic indicators.

First on the SFEM. There is no doubting the fact that SFEM has introduced an incredible orderliness in the allocation, utilisation, and management of foreign exchange in Nigeria in contrast with the chaotic import licensing system. More and more banks now bid for less than the maximum allowed them, indicating that the demand for foreign exchange may be falling. The demand may well fall further as local producers take advantage of relatively high import prices to produce local substitutes. Available evidence indicates that over 80% of the foreign exchange bought in SFEM is for raw materials and spare parts. It also indicates that manufacturers are turning increasingly to the use of local raw materials especially in the Breweries and other agro-allied industries. This development will not only reduce the balance of payments pressures but would also create local employment and boost the growth of the domestic economy.

Local producers and Nigerian exporters are also reacting favourably and taking advantage of the more realistic exchange rate and the decontrol of exports. Indeed a number of export products are already enjoying higher prices. An example is cocoa which now fetches about N4,000 per tonne compared with N1,600 per tonne pre SFEM¹⁰.

Observed developments point to SAPs potential to attract foreign exchange inflow. This is evidenced by the increase in the domiciliary account from N0.5m in January 1986 to over N25m in October with over a third of the inflow occurring in October 1986¹¹.

It has also been observed that small and medium scale firms will be better placed under SFEM than under the previous import licensing system. This is because they had always operated on cash basis and the prevailing cash basis transaction at SFEM suits them, since foreign currencies are cheaper in SFEM than in the black market which they had patronised over the years¹².

10 Ogbe op. cit.

11 Ibid.

12 G.O. Moneke: Second Tier Foreign Exchange Market (SFEM): — Implications for Medium and Small Scale Industry in Nigeria, MBA dissertation (unpublished) University of Lagos, January, 1987 p. 105.

The impact of abolishing the import licensing system has been very pronounced. Businesses are now spared the wastage of valuable executive time spent in parading the corridors of the Government authorities responsible for issuing the licences. They have also been spared the menace of import licence hawkers and the costs involved in retaining their services. Also eliminated is the uncertainty of the value of foreign exchange purchased under the import licensing regime when Central Bank delays in remittances and subsequent surcharging of importers meant that products were sold without the importers knowing whether or not they were selling below cost. So the capacity to plan which flows from paying the real value for the foreign exchange which becomes immediately available has made enterprise management much less a nightmare than it used to be.

Also very profound is the impact of the abolition of price control. The Nigerian experience indicated that the only person controlled was the manufacturer or producer. Once past his factory gates the products fetched a market value far out of proportion than he really got for them. This deprived the industries the much needed earnings for reinvestment in expansion so as to benefit from the greater economies of scale or in research and development for local sourcing of inputs. The earnings were rather lost to distributors who had no stake in local sourcing. Following the abolition of price control, the rush to middlemanism and distributorship is less now than hitherto. Aptly illustrating this fact recently at the inauguration of boards of parastatals under the Ministry of Industries, Professor Aboyade remarked he got only two congratulatory messages on his reappointment as Chairman of Volkswagen of Nigeria in comparison to the deluge of congratulatory messages he got the first time around in 1984¹³.

5. Conclusions

In the proceeding sections an attempt was made to highlight some of the malaise affecting the economy and how these malaise are addressed through SAP, of which SFEM is a core part. Reference was also made to fiscal and monetary policies in the management of the economy and the point was made that while fiscal policies were expansionary in some respects, monetary policy is purposely restrictive to help to contain or restrain the attendant inflationary pressures from the operation of SAP.

13 Pat Utomi: The SAP - A critical assessment - paper presented at the Institute of Bankers Symposium on SAP: A critical assessment in Kano on March 20, 1987.

It remains to conclude by saying that the problems affecting the economy are severe and structural in nature and only a shock therapy is needed to effectively address the structural defects in the system. SAP of which SFEM is a major component is providing such a therapy. Although it has been in operation for barely nine out of the twenty four months it is scheduled to operate at the end of which the economy is expected to have been fully revamped into a path of self-reliant and sustained growth, there is no doubt SAP is already effectively addressing the structural distortions in the economy. It is designed to enable the economy move away from the old course of seeing and doing things that enslaved the economy to the external sector and government. It was decided upon after a long period of soul searching which seriously questioned the conventional wisdom, rejected the thrust of economic policy and management of the past twenty-five years and ushered in a philosophy of decontrol and greater reliance on market forces. This revolutionary change in economic management must be encouraged and supported by all and sundry to succeed.

This success demands two imperatives. One is political stability to strengthen the confidence of investors - both indigenous and foreign. Real or imaginary fears about the political stability of the country will weaken this confidence, engender a wait and see attitude, strifle any meaningful planning as a result of uncertainty, weaken the structural adjustment programme and postpone the nation's economic recovery.

The second imperative is a proper integration of the needs of different sectors of the economy such that the gains in one sector do not lead to loss in other areas of the economy. This requires a tariff structure that does not make it more attractive and profitable to import rather than produce locally.

Abstract

The Structural Adjustment Programme was adopted by the Nigerian authorities as a result of the failure of the largely demand management and control measures of the past twenty-five years. It aims at a reordering of aggregate domestic expenditure and production patterns in the economy with a view to reducing Nigeria's import dependence through a more realistic exchange rate and de-regulation of the economy. Other objectives include privatisation of commercial interests of government, stimulation of research and development, increased local sourcing of industrial inputs, and revitalisation of the agricultural sector for self reliance in food production; export promotion and stimulation of foreign capital inflows.

An interim assessment suggests that the policies are in the right direction. A change in the national orientation is already occurring; the sellers market syndrome is giving way to consumer resistance and sovereignty; compared with the chaotic import licensing and price control system of the past, there is more orderliness in the foreign exchange allocation system through the Second Tier Foreign Exchange Market (SFEM); exporters are reacting more favourably and taking advantage of the more realistic exchange rate and decontrol of exports. Although foreign investors still adopt a wait and see attitude, capital inflows through the domiciliary account are indications of reviving confidence in the economy. This confidence will be further strengthened by continued political stability and the objectives of SAP achieved by ensuring that the tariff structure does not make importing more attractive and more profitable than producing locally.

UNE POLITIQUE ÉCONOMIQUE POUR LE NIGÉRIA DANS LE CONTEXTE D'UN PROGRAMME D'AJUSTEMENT STRUCTUREL: POLITIQUES MONÉTAIRES ET DOUBLE MARCHÉ DES CHANGES

RESUME

Le programme d'ajustement structurel fut adopté par les autorités du Nigéria à cause des résultats décevants des politiques de la demande globale et des mesures de contrôle appliquées dans les 25 dernières années. Ce programme tend à restructurer la dépense intérieure et à modifier la production en vue de réduire la dépendance des importations du Nigéria; comme moyens on a choisi un taux de change plus réaliste et un processus de de-réglementation de l'économie. On peut signaler d'autres objectifs tels que, par exemple, la privatisation des activités économiques du gouvernement, l'accroissement des dépenses de recherche et de développement, la stimulation des facteurs de production locale pour le secteur industriel, la revitalisation de l'activité agricole de façon à atteindre l'autosuffisance en matière de production alimentaire et, enfin, l'augmentation des flux de capitaux étrangers.

Une évaluation provisoire de cette nouvelle politique montre que l'on est sur la bonne voie. On prévoit déjà des changements dans les grandes options au niveau national, l'expérience des marchés dominés par les vendeurs laisse la place aux préférences et à la souveraineté des consommateurs; les exportations réagissent favorablement et sont avantagés par des taux de change plus réalistes et par une plus grande liberté des exportations; le système du double marché des changes (S.F.E.M.: Second Tier Foreign Exchange Market) a favorisé une allocation plus rationnelle des devises étrangères en comparaison avec le précédent système basé sur une méthode chaotique de permis d'importation et de contrôle des prix.

Les investissements étrangers ont une attitude encore méfiante, toutefois les flux des capitaux indiquent que la confiance dans le nouveau programme est en train de revenir. Cette confiance sera toujours plus forte grâce au maintien de la stabilité politique; les objectifs du programme d'ajustement structurel seront atteints si la structure tarifaire ne rend pas les importations plus rentables que la production locale.

