

# TECHNIQUES OF MONETARY CONTROL: THE NIGERIAN EXPERIENCE

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1. When the establishment of the Central Bank of Nigeria (CBN) was being contemplated in the 1950's, some experts opposed it on the ground that it would be « an expensive luxury ». The CBN nonetheless, was established in 1959, equipped, like other central banks the world over, with an armoury of techniques of monetary control. This short brief examines the experience of the Bank in employing the techniques to achieve monetary stability through controlling the quality, price and direction of money and credit during the two decades of the Bank's existence.

2. A feature that stands out clearly in the annals of central banking in Nigeria is the extent to which the CBN has not made much use of the conventional techniques of control. Although it acquired the powers right from its inception, the CBN, for instance, has not made use of open market operations nor has the Bank made use of the variable liquidity ratio which has remained at 25% since 1962<sup>1</sup>. Similarly the CBN has not utilised its powers to call for special deposits from the commercial banks except once in June 1971. Although an enabling Act enjoins the CBN to fix, vary and « make public at all times its minimum rediscount rate or bank rate » and although under the 1968 amendment, commercial banks' borrowing and lending rates were linked to the minimum rediscount rate (MRR), changes in commercial banks' borrowing and lending rates have been secured by direction rather than by changes in the MRR.

The CBN, has, of course, made use of two quantitative techniques. One is the cash reserve ratio and the other is stabilisation securities and the two were used rather belatedly in 1976 in the wake of the « excess liquidity » syndrome that followed the short-lived oil boom of 1973/4. Following the continuing high liquidity position of the banking system observed in the previous year, the CBN, in 1976, called on each commercial bank in the country to maintain with it (i.e. CBN) a cash ratio expressed as a ratio of its total demand deposits plus time deposits. The ratios ranged from 5 to 12.5 per cent and varied with the size of the bank's deposit liabilities. They were reduced by 50% in 1979 and now range between 2 and 5% as follows:

Class of Bank	Amount of relevant deposits	Stipulated cash reserve ratio (%)
A	N300m or more	5.0%
B	N100m or more but less than N300m	4.0%
C	N30m or more but less than N100m	3.0%
D	less than N30m	2.0%

1. The liquidity ratio was fixed at 30% in 1958 but was reduced to 25% in 1962 and has remained at that level since then.

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Similarly, based on the powers the CBN acquired under the 1968 Amendment, the Bank, in 1976, issued « stabilisation securities »<sup>2</sup>. Based on increases in each bank's savings deposits over the level outstanding on 31 March 1976, the stabilisation securities were in respect of individual savings account not exceeding N.20,000. The CBN paid the banks 4% per annum on the stabilisation securities which were non negotiable, non transferable and not eligible for calculating the statutory liquidity ratio. The stabilisation securities were completely phased out in 1980.

3. It is clear therefore that the CBN employed the cash reserve ratio, stabilisation securities and « special deposits » to attend to special exigencies and that the tools were largely abandoned as soon as the exigencies were perceived to be over. This is as it should be. It is clear also that the CBN has not employed the techniques of open market operations and Bank rate. One explanation for the lack of use of these techniques is the traditional view that these techniques are inoperative and ineffective in a developing economy like Nigeria's without developed money and capital markets.

In the light of the above, how has the CBN been regulating money and credit in the country, if, as shown above, it has not employed open market operations and Bank rate techniques and has used special deposits, stabilisation securities and cash reserve ratio only on special occasions? The answer is that the CBN has relied on two techniques: moral suasion and « Guidelines ».

4. Moral suasion has been continuously used by the CBN since its inception. The Bank first relied on it in its early years to get the Banks to « behave »; and even when the CBN was forced by the exigencies of the situation to employ other weapons, it nevertheless continued to rely on a high degree of persuasion to get the banks to comply. However although moral suasion was successful in persuading the commercial banks to lend money to Nigerians to buy foreign businesses under the indigenisation exercise, on the whole, it was ineffective. This was partly because the magnitude of the problem faced by the CBN demanded more than mere « suasion ». In many cases too, the suasion was expressed in very general and imprecise terms, thereby leaving it to the banks to interpret and

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2. The 1968 Amendment empowered the Bank « for the purpose of maintaining monetary stability to issue, place, sell, repurchase, amortise or redeem securities to be known as stabilisation securities (which shall constitute its obligations) at such rate of interest and under such conditions of maturity, amortisation, negotiability and redemption as the Bank may deem appropriate.

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implement as they thought fit. Experience has also shown that moral suasion has usually been effective where there are « gentlemen » and the institutions being persuaded are few and of comparable sizes. This is why the technique has usually been very effective with the clearing banks in the United Kingdom and very ineffective and indeed not used at all in the United States where the institutions are many and diverse and vary with respect to capital resources and market situations they face. Indeed this is a primary reason why moral suasion has been ineffective in Nigeria: disparities exist between banking institutions and their sizes and the market situations they face.

5. Against the background of ineffective moral suasion and non use, or lack of use of the other weapons, the CBN has relied almost exclusively on « Guidelines » to regulate the quantity, direction and price of money and credit in the country.

First introduced in 1964 and in continuous use since 1969, the Guidelines are annual monetary policy circulars issued by the CBN directing the banks as to the quantity, the direction and the price of money and credit to the private sector, the objective being to direct more credit to prescribed preferred sectors and away from less preferred sectors. The Guidelines have the following main features.

One is absolute ceiling on bank credit. Absolute ceiling on the growth of bank credit was introduced in 1964, withdrawn in November 1966 reintroduced in 1970, removed again in 1972 and reintroduced again in 1976/77 and has been on since then. From 40% in 1976/77, the ceiling now stands at 30%; but new banks and those with loans and advances of not more than N100m as at the end of March in each year might increase their loans and advances by as much as 40% or 70% of their total deposit liabilities (excluding government deposits maturing earlier than six months) which ever is higher.

The second feature is sectorial allocation. Within the absolute ceilings established, banks were directed to grant more credit to the preferred sectors (which comprise of production, service, and export (included in 1980) and development finance institutions (included in 1981) and less credit to the less preferred sectors (which are general commerce and others)<sup>3</sup>. Each sector is broken into furt-

3. Even in the years when absolute ceilings on the growth of bank credit were removed, banks were nevertheless urged to grant more credit to the preferred sectors and less credit to the less preferred sectors.

her activity sectors with specific percentage allocations prescribed. While the allocations for the preferred sector were regarded as minima, those for the less preferred sectors were maxima. In the 1981 Monetary Policy Circular, for instance, the minimum for the productive sector was prescribed as 75% while the maximum for the less preferred sector was 25% of total bank credit.

The third feature of the Guidelines is loans to indigenous businessmen. Following a survey carried out by the CBN in 1969 which revealed that the then expatriate banks (which controlled over 80% of the banking business in the country) granted on the aggregate only about 25% of their loans and advances to indigenous borrowers and 75% to expatriate borrowers, the CBN directed all commercial banks to grant, on the average, a minimum of 35% of their loans and advances to indigenous borrowers by 31st December 1970. This proportion was increased to 40% in 1973 and to 50, 60% and 70% respectively in 1977, 1978 and 1979. In 1979 the CBN directed that of the 70% at least 10% should go to wholly Nigerian owned enterprises and in 1981 this was increased to 16% distributed as follows based on annual business turnover:

Class of Bank	Amount of relevant deposits	Stipulated cash reserve ratio (%)
A	up to N25,000	1.6%
B	over N25,000 and up to N50,000	1.6%
C	over N50,000 and up to N100,000	3.2%
D	over N100,000 and up to N200,000	4.0%
E	over N200,000 and up to N500,000	5.6%

The fourth feature of the guidelines is that the rates which banks charge on various categories of loans and pay on various categories of deposits are also stipulated. In this way changes in interest rates are secured by direction rather than by automatic movements in any base rate such as the Bank's Minimum Rediscount Rate.

There is, finally, the feature of flexibility. First limited to commercial banks the guidelines were extended to cover merchant banks as from 1976, and insurance companies as from 1978 with respect to interest rates and rendering of returns. Another illustration of the flexible use of the guidelines is the exclusion from the aggregate ceiling of loans granted to Nigerians to purchase alien businesses



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under the second phase of the indigenisation exercise. Also excluded from the credit ceilings with effect from 1979 were loans granted to workers in both the public and private sectors for the purchase of motor cars and loans to agriculture and residential building construction, over and above the minimum prescribed under the sectorial distribution of loans and advances.

6. CBN's experience with the Guidelines has been very rewarding: bank loans and advances are now being successfully rechannelled to the productive sectors of the economy. Between December 1968 and September 1980, for instance, the productive sectors had increased their share of aggregate loans and advances from less than 33 to over 70%, the most dramatic subsectors being agriculture whose share rose from 1.7% to 6.7% and manufacturing from 16.4% to 32% while general commerce decreased its share from 52% to 17% during the period. Similarly, the share of the less preferred sectors fell in the aggregate from 63% in 1969 to 25% in 1981.

Secondly through the guidelines, the CBN has been able to induce the banks to channel more bank loans and advances to indigenous borrowers. For instance, while all commercial banks increased the share of their total loans and advances going to indigenous borrowers from 55% in 1970 to 88% in September 1980, indigenous banks increased their share from 83.3% in 1970 to 95.2% in 1980 and expatriate (now mixed) banks increased their share from 25% in 1969 to 84.4% in September 1980.

A major factor explaining the above impressive performance in increasing loans to indigenous borrowers was the Indigenous Enterprises Promotion Decree and the definition of indigenous borrowers to businesses in which Nigerian equity participation is not less than 51%. This made it possible for a bank to achieve full compliance with the guidelines without necessarily extending credit facilities to small scale enterprises wholly owned by Nigerians, for whom the policy was originally designed.

It is for the above reason that, effective from April 1979, a specific percentage share was allocated to the small scale enterprises wholly owned by Nigerians as indicated above, but this aspect of the policy has not proved very successful. In fiscal 1979/80 and 1980/81, the banks failed to reach the targets in respect of loans to small scale enterprises wholly owned by Nigerians.

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The failure of the banks to meet the target set for loans to wholly Nigerian owned small scale enterprises illustrates an essential aspect of the guidelines which is that they are hardly effective unless accompanied with penalties or threat of penalties in case of default. In fact, the guidelines were relatively less effective and rarely ever fully complied with until 1976 when penalties for non-compliance were stipulated following the Report of the Anti-Inflation Task Force late in 1975. Penalties were also imposed for not complying fully with the guidelines in respect of loans to agriculture and residential building construction. For instance, where a bank's total monthly loans and advances to these sectors fall short of the prescribed minima (currently 6% and 5% for agriculture and residential housing construction respectively), the bank is required to deposit the short-fall with the CBN for as long as and to the extent that shortfall continues and such deposits do not attract any interest nor count as part of liquid assets.

Another factor that militated against the successful operation of the Guidelines before 1976 was non-distinction among banks as to sizes and types of market situation they face and the fact that the guidelines were until 1976 limited to commercial banks and therefore excluded merchant banks and insurance companies. As pointed out above, while the latter were included as from 1978/79 with respect to interest rates and rendering of returns, the merchant banks were included in 1976. Similarly since 1979, the guidelines have been discriminating among banks with respect to sizes and market situations.

7. Few lessons may be drawn from the above discussion of CBN's experience with techniques of monetary control over the two decades of its existence.

First in terms of monetary control, a central bank in a country with underdeveloped or no money and capital markets need not be an « expensive luxury » unless a doctrinaire approach is adopted. The central banker in such a situation should easily discard the tools it finds ineffective or inoperative and innovate and employ those tools that can deliver the goods. This is precisely what the CBN appears to have done by ignoring the traditional techniques of open market operations and bank rate changes and innovating and relying on the « Guidelines ».

Secondly in the CBN's experience, the guidelines have proved a potent instrument in effecting a structural transformation in the banking system's loans and advances away from such activity sectors like general commerce that do not contribute much to economic development of the country to the productive and preferred sectors that are in consonance with national policy objectives.

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Thirdly while the erstwhile expatriate banks almost totally ignored the indigenous borrowers in their loans and advances on the grounds that they were not credit worthy, with the use of the Guidelines, the CBN has been able to achieve an operational orientation of these banks and of the entire banking system into granting more loans and advances to indigenous borrowers.

Fourthly, the CBN's experience illustrates that given the magnitude of the problems facing a developing economy, moral suasion is not enough to secure compliance of the banks to desired policy objectives. Some element of penalty or threat of it in case of default is inevitable to secure the bank's compliance.

Finally, the CBN's experience indicates that since cooperation rather than coercion is required, the monetary authorities need not start initially with penalties but they need not carry persuasion to a point of irrelevance. They should rather examine and assist in removing reasonable obstacles or excuses for non compliance and enforce the penalties thereafter. In this connection, three steps taken by the CBN to assist the banks to comply with the sectorial allocation of credit stipulated in the Guidelines deserve mention.

First, the Bank in 1974, introduced a Bill Refinance Scheme under which it undertook to rediscount certain medium-term loans granted by the banks to the productive sectors. Secondly, in collaboration with the Federal Government, the CBN in 1977 introduced the Agricultural Credit Guarantee Scheme under which the Bank guarantees against losses up to 75% of a loan granted by banks for agricultural purposes as an incentive for banks to lend more to agriculture. Finally, the CBN excluded from the credit ceilings loans and advances granted by banks for the purchase of shares under the second phase of the indigenisation exercise and from 1979 loans granted to agriculture and residential building construction over and above the minimum prescribed under the sectorial distribution of loans and advance were also excluded.

## **TECHNIQUES DU CONTROLE MONETAIRE: L'EXPERIENCE NIGERIEENNE.**

*Lorsque la constitution de la Central Bank of Nigeria (CBN) a été prise en considération au cours des années 50 quelques experts s'y opposèrent retenant que ceci aurait été un « luxe trop coûteux ». Malgré cela, elle a été établie*

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*en 1959 et équipée, comme d'autres banques centrales dans le monde entier, d'une importante quantité de techniques pour le contrôle monétaire. Le court exposé qui suit prend en considération l'expérience de la banque pour ce qui concerne l'emploi de techniques aptes à atteindre la stabilité monétaire au moyen du contrôle de la quantité, du prix et de la direction de la monnaie et du crédit pendant les vingt années d'existence de la banque.*

*Un trait qui ressort clairement d'après les annales des banques centrales au Nigeria est l'emploi peu fréquent fait par la CBN des techniques de contrôle conventionnelles, telles que les opérations du libre marché, taux de liquidité variable ainsi que l'arme traditionnelle du taux bancaire. Elle a naturellement fait usage du coefficient de trésorerie et des titres de stabilisation mais seulement en cas exceptionnel.*

*La CNB a plutôt fait oeuvre de persuasion et s'est limitée à fournir des critères généraux de conduite pour ce qui a trait au crédit. Bien que cette persuasion ait été à même de convaincre les banques commerciales de prêter de l'argent aux Nigériens dans le but d'acheter des entreprises étrangères sous la gestion indigène, dans son ensemble elle n'a pas eu le succès espéré en particulier à cause du fait que les institutions à « persuader » étaient plusieurs et disparates par rapport aux sources du capital et aux situations de marché.*

*Introduites pour la première fois en 1964 et toujours en usage depuis lors ces « Lignes de conduite » avec leurs critères de flexibilité établissent des Plafonds absolus et par secteur dans le but de garantir plus de crédit aux secteurs privilégiés et aux hommes d'affaire indigènes. Ce fut une expérience profitable. Les prêts et avances bancaires sont actuellement canalisés avec succès vers les secteurs productifs de l'économie et accordés aux hommes d'affaire indigènes.*

*Par exemple, entre décembre 1968 et septembre 1980, les secteurs productifs ont augmenté au total leur part de prêts et avances de moins 33% à 70% tandis que les prêts allant aux hommes d'affaire indigènes ont augmenté de 55% en 1970 à 88% en septembre 1980.*