

ANALYSIS OF RESTRICTIVE FINANCIAL SECTOR POLICIES IN NIGERIA, 1970-1986.

O.B. Oyewole
University of Bradford.

1. Introduction

The contemporary discussion of financial policy in developing countries, in recent times, tends to focus mostly on the financial liberalisation issues while little reference is often made to the various restrictive policies that preceded liberalisation.¹ Even when financial repression is discussed, it is usually confined to interest rate restriction with passing reference to other instruments of financial restriction or repression² in these countries.

However, for better understanding of financial liberalisation policies in developing countries, there is the need to analyse the various restrictive measures that led to the adoption of financial liberalisation in the first place. Such an analysis will better illuminate the need for financial reforms as an alternative financial development strategy as recommended by the neo-liberal economists.³

The kernel of the neo-liberal thesis is that the growth of the financial sector in developing countries has been restrained by government repressive measures. Shaw (1973, p.81) defined financial repression as "a standard package of intervention which consists of a positive and variable inflation rate alongwith stipulation of loan and deposit rates at banks and other financial institutions of the organised financial markets". In the same vein, McKinnon referred to financial repression as the reduced ability of private sector financing due to the absorption of institutional savings by the government.

However, Fry (1988) argued that the real intention of governments in developing countries is not financial repression but financial restriction. He defined financial restriction as the formulation of financial policies that promote financial institutions and instruments from which the government can derive significant revenues and discouraging those that would not adequately fulfill this objective (p.14). Thus, in developing countries, finan-

1. The emphasis on financial liberalisation is understandable, given the growing number of developed and developing countries that have adopted this policy in the past two decades. In particular, the liberalisation of the financial sector is among the conditions for financial assistance from international financial institutions to developing countries. The need for such assistance following dwindling financial inflows and the growing need for financial resources made the compliance to this condition a matter of necessity.

2. Financial repression and restriction will be used interchangeably throughout this paper.

3. For a detailed review of the theoretical arguments of the neoliberal propositions for financial reforms in developing countries see McKinnon (1973), Shaw (1973), and Fry (1988).

cial restriction could explain the dominance of the money and banking sector⁴ which can easily be made to supply the financial needs of the government at low costs.

In Nigeria, with the adoption of development planning strategy, the government felt that the financial sector should be made to play a more active role in financing the development aspirations of the country as contained in the plans. Therefore, a series of repressive measures were introduced into financial policy formulation. These include the use of financial savings by the government, interest rate stipulations and government intervention in the credit allocation through selective credit policies. The restrictive measures were further intensified in 1976, with the review of the financial sector following the recommendations of a Financial System Review Committee (FSRC) set up by the government.

The FSRC was given the task of recommending the "ways and means" by which the financial sector could be better used in harnessing the necessary financial resources for achieving the targets and goals of the Third Development Plan. Following the acceptance of the FSRC recommendations, the ownership of financial institutions was restricted, the regulation of interest rates was intensified, reserve requirements increased and government intervention in credit allocation became more pervasive. These restrictive financial policy measures were usually articulated in the annual fiscal and monetary policies of the government and monetary authorities until June 1986, when financial reforms were undertaken.

From the foregoing, the objective of this paper is to analyse the various restrictive financial policies of the government during the 1970-1986. The analysis will reveal the need for adopting the recent liberalisation of the financial sector in the country. It should be noted, however, that the focus of this paper is limited to highlighting the restrictive policies that constrained the effective performance of the financial sector during the study period. The analysis of financial sector performance could not be undertaken here due to space considerations.

The paper is organised into five parts with this introduction forming part one. Part two discusses the use of financial savings by the government to finance its operations. Part three looks at the control of ownership and entry of financial institutions. In part four, the various instruments of monetary policy which impacts considerably on the performance of the financial sector is analysed while part five concludes the paper.

4. The dominance of the banking sector in developing countries was highlighted by the World Bank in its 1989 World Development Report (p. 53).

2. Use of Financial Savings by the Government

It is paradoxical that despite an oil boom during the study period, fiscal deficits were a feature of government finances throughout the study period. This paradox was observed by Kirk-Green and Rimmer (1981, p. 127) when they stated that:

Among the remarkable features of Nigerian fiscal history is the rapidity with which government spending adjusted to the vast accession of revenues from oil.

Table 1:

PUBLIC SECTOR FINANCING BY THE BANKING SECTOR IN NIGERIA, 1970-86

(= N = Million)							
Year	1 Budget Deficits	2 PSBR	3 Foreign Financing	4 Domestic financing Bank	5 Non-Bank	6 Total DF	7 Bank/DF 4/6 (%)
1970	2,006.1	3,379.0	20.2	1,096.2	909.9	2,208.1	50.1
1971	1,082.4	3,257.7	25.3	885.6	564.6	1,475.5	61.1
1972	1,285.2	3,108.7	21.2	906.7	433.9	1,361.8	67.6
1973	907.8	2,872.6	28.5	578.1	217.7	824.3	72.6
1974	1,796.4	2,733.6	45.5	964.6	2,243.8	3,253.9	30.1
1975	1,427.9	4,046.5	27.5	362.9	142.7	533.1	71.8
1976	1,090.8	4,991.1	24.5	620.0	446.1	1,090.6	58.2
1977	3,781.4	8,613.5	9.5	2,056.8	3,347.2	5,413.5	38.1
1978	2,821.9	6,769.2	1,009.0	3,210.1	3,879.5	8,098.6	45.3
1979	2,070.6	9,676.7	1,083.4	5,862.7	5,204.9	12,151.0	53.0
1980	6,116.7	14,817.1	255.3	872.6	847.3	1,975.2	50.7
1981	4,829.8	14,920.2	464.4	2,363.6	(119.5)	2,709.0	92.8
1982	6,502.6	12,162.1	263.5	2,989.2	2,851.4	6,104.1	51.2
1983	6,002.7	11,051.1	1,106.9	5,616.1	5,174.4	11,897.4	52.1
1984	2,732.8	9,284.6	450.0	3,483.8	1,403.1	5,336.9	71.3
1985	4,051.9	6,029.3	1,045.9	2,761.5	2,272.9	6,080.3	54.9
1986	9,181.1	12,601.5	708.1	2,498.9	8,352.8	11,559.8	30.3

Note: PSBR = Public Sector Borrowing Requirements.

DF = Domestic Financing. This is the amount of government borrowings from the domestic financial sector to finance the PSBR.

Sources:

CBN; Annual Reports & Statement of Accounts, various years.

IMF; Government Finance Statistics, various years.

IMF; International Financial Statistics, various years.

From Table 1, government budget deficits increased from = N = 2,006.1 million in 1970 to = N = 9,181.1 million in 1986. Similarly, the Public Sector Borrowing Requirements

(PSBR) (which is the amount of funds that the government must raise, in the financial sector or abroad, to pay for its expenditures net of tax and other revenues) increased from = N = 3,379.0 million in 1970 to = N = 14,920.2 million in 1981 but declined to = N = 12,601.5 million in 1986.

The domestic financing of government borrowing requirements through the banking sector which declined from = N = 1,096.2 million in 1970 to = N = 620 million in 1976 increased drastically to = N = 2,056.8 million in 1977. It behaved erratically onwards with significant increases in 1979 and 1983 to = N = 5,862.7 million and = N = 5,616.1 million respectively.

In percentage terms, the share of the banking sector in total domestic financing of the PSBR declined from 50.1 percent in 1970 to 30.1 percent in 1974 due to increased oil revenues. It fluctuated onwards and peaked at 92.8 percent in 1981 before declining to 30.3 percent in 1986, averaging 56 percent of all sources of financing during the period.

Further insights into the use of banking sector to finance government fiscal operations are given by Table 2 which analyses the ownership and maturity pattern of government domestic debts outstanding during the 1970-86 period. The total outstanding domestic debts of the government increased from = N = 1,094.9 million in 1970 to = N = 28,452.2 million in 1986.

Ownership of the debts shows that the banking sector was dominant. Its share increased from 48.5% in 1970 to 79.8% in 1986. Within the banking sector, the Central Bank of Nigeria (CBN) remained the dominant holder of government debt as in most developing countries.⁵

Furthermore, the maturity pattern of government domestic debt displays the predominance of short-medium term debts. These are mostly made up of treasury bills and certificates⁶ (debt instruments which are mandatory issued by monetary authorities

5. According to World Bank (1989a, p.62), in these countries, governments turn to central banks because domestic financial markets were too shallow to meet their financial requirements. Also, Kitchen (1986, p.111) has labelled this type of borrowing by the government from the financial sector as "protected borrowing". According to him, these are government borrowings due to legal and administrative restrictions imposed on the financial sector by the government.

6. In addition to treasury bills and certificates, other short-term debt instrument of the government during this period but which were later discarded was ways and means advances. However, they represented an insignificant amount of such debt category.

to the banks at low interest rates to raise money for the government). The total value of such category of debts rose from 49.4% in 1970 to 69.3% in 1986. Long term domestic debts, made up mainly of development stocks, rose from 50.6% in 1970 to 30.5% in 1986.

Table 2

ANALYSIS OF OWNERSHIP AND MATURITY OF OUTSTANDING GOVERNMENT DOMESTIC DEBTS, 1970-1986.

(Percentages)

Maturity/ Ownership	Short and Medium Term			Long Term			Total		
	1970	1980	1986	1970	1980	1986	1970	1980	1986
A. Banking Sector	68.7	78.1	95.1	26.8	61.6	44.5	48.5	71.4	79.8
Central bank	41.2	42.2	74.2	17.3	33.2	35.0	29.1	38.5	62.3
Commercial and Merchant banks	27.5	35.9	20.9	11.5	28.4	9.5	19.4	32.9	17.5
B. Non-bank Public	31.3	21.9	4.9	71.2	38.4	55.5	51.5	28.6	20.2
Total (A + B)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

i. Short & Medium term debts include treasury bills, treasury certificates and ways & means advances;

ii. Long term debts consist of development stocks, bilateral loans and National Reconstruction Development Certificates.

Source: CBN, Annual Reports and Statement of Accounts, various issues.

However, it is worth noting that government debt owed to the non-bank public sector were concentrated on the long term maturing debts during the period. This is due to the fact that public enterprises and institutions were compelled to invest in development stock.

The foregoing analyses highlighted the significant use of the banking sector in financing government borrowing requirements. This high dependence on the banking sector for government borrowings created a situation in which a significant part of mobilised domestic savings went into financing the government and thereby, constrained efficient intermediation by financial institutions during the period.

3. Restricted Ownership of Financial Institutions

Controls on the ownership and entry of financial institutions were also employed to restrict the activities of the financial sector by the government. Restrictive policies towards

the financial sector not only limited foreign participation in the sector but also caused the government to assume greater ownership of financial institutions. The thinking of the government was that by taking over the ownership and control of the financial sector, it would be more responsive to the development aspirations of the country while at the same time facilitating financial development.

Hence, as part of the indigenisation programme in 1972, the government acquired 40% of the equity of all foreign banks in the country.⁷ In 1977, following the recommendations of the Review Committee in 1976, financial institutions were classified under schedule 2 of the 1977 Indigenisation Act. The Act specified a maximum of 40% foreign equity in activities in this schedule. Thus, the government increased its ownership of financial institutions to 60 percent.

With these policies, the government assumed control of virtually all financial institutions in the country. For example, out of 28 commercial banks operating in the country before financial reforms, 22 had government majority ownership compared to 6 with private majority ownership. Foreign ownership of the banks does not exceed 40 percent in compliance with the indigenisation policy mentioned earlier.

The majority ownership of financial institutions gave the government the power to appoint persons on the Board and other senior management positions in these institutions. This was a major factor contributing to inefficiency in the financial sector prior to reforms. For example, during the 1980-86 period, the Board and Chief Executive Officer of government owned institutions were changed about five times. According to Olashore (1988, p.126), a former chief executive of a major commercial bank in Nigeria:

...government appointment of the management of banks removes the independence of the management of the bank and makes it subject to political fear and favour. This is particularly glaring in the state-owned banks which have become ineffective because of the instability in the formulation and pursuance of operating policies consequent on the frequent changes in the board membership and top management positions.

Furthermore, the entry of financial institutions into the financial sector was restricted by the government through restrictions on the licensing of new financial institutions. Although this policy was not made explicit, few institutions were granted permission

7. According to Nwankwo (1981, p.77), the objective of the policy as stated in the 1973/74 budget statement is for the Government to get intimately involved in Commercial Banking activities so as to guide them to operate to the maximum benefit of the economy. See Nwankwo (1981) for more discussions on this subject.

to operate during the period, despite the high population per bank ratio in the country during the period. For example, only 16 commercial banks were established during the 1970-85 period. By contrast, following the liberalisation of financial restrictions in 1987, new commercial banks increased from only 4 in the three years preceding reforms (1984-86) to 18 in the three years (1987-89) of the programme. Similarly new merchant banks increased from 2 to 22 during the same period. While numerous finance houses and mortgage finance institutions have been established since financial reforms.

Therefore, the restrictions on ownership and entry of financial institutions contributed to the operational inefficiency of financial institutions during the period. This observation was also noted by Nwankwo (1980, p.80) when he stated that the problem of financial institutions in Nigeria is not "ownership as addressed in the indigenisation decree but operational orientation".

Apart from the ownership of financial institutions, the Government, through the financial authorities, employed monetary policy instruments that tend to restrict the operations of the financial sector during the regime of financial restrictions. These instruments will form the focus of the next section.

4. Instruments of Monetary Policy

The choice of monetary policy instruments and the evolution of the financial system are inextricably interrelated. This is due to the fact that the relative importance of banks in total financial intermediation, the size of the financial market, the barriers to entry into banking, the pace and extent of financial innovation, the nature of bank competition and conceptions about how banks react to the use of different policy weapons determine the types of instruments that are given prominence as well as the way they are designed and used (OECD, 1985, p.103). Hence, the monetary policy being pursued by a country will have a far reaching effect on the development of the financial sector and the operations of financial intermediaries.

The instruments employed by the monetary authorities to influence the operations of financial institutions will be examined in the ensuing sub-sections.⁸ The CBN, being

8. In this study, emphasis is on those instruments of fiscal and monetary policies that affect the operations of financial institutions. The analysis of monetary policy outcomes has not been discussed here to give room for a detailed analysis of policy instruments. Apart from this, monetary policy during the period has been widely studied. For details see CBN, 1979; Fakiyesi, 1984; Nwankwo, 1981; Ojo and Adewunmi, 1982 and Onoh, 1982.

the executor of government monetary policies was, in the words of Nwankwo (1981, p.115), "equipped with an armoury of techniques of monetary control". However, of all the monetary policy instruments available to the CBN, the most widely used and which seem to have exerted profound influence on the development of the financial sector are interest rates, reserve requirements and selective credits. Each of these instruments are discussed below in succession.

4.1 Government Intervention in Interest Rates

While the determination of an appropriate level of interest rates or the development of market determined interest rates is often difficult to achieve, the attainment of a market based interest rate structure through minimum distortions is desirable. To this end, Leite and Sundararajan (1990, p.15) observed that:

The Government has an important role in promoting competition, and also in ensuring that its financing operations do not distort market rates.

In Nigeria, the stipulation of interest rates on financial assets is part of the annual monetary policy guidelines of the CBN. The Banking Amendment Act of 1962 gave the CBN the power to control the interest rate structure when it provided that:

Rates of interest charged on advances,... and the interest rate of each licensed bank shall be subject to the approval of the central bank and the minimum rate of interest so applied shall be the same for all licensed banks.

Also, the 1969 Banking Decree (section 14) empowered the CBN not only to control but to determine and to prescribe the minimum and maximum interest rates chargeable by the various financial institutions. In 1970, the CBN issued a directive compelling commercial banks to link their interest rates to the minimum rediscount rate⁹.

The interest rate stipulations caused nominal interest rates to be relatively stable despite inflationary pressures in the country and thereby, resulted in negative real interest rates¹⁰ for most of the 1970-85 period in the country. From Table 3, real interest rates

9. See Amendment to Banking Decree (1970, section 40) which authorised the central bank to approve interest rates for different classes of licensed banks in the country.

10. Real interest rates were estimated as follows:

$$RINT = [(1+r) / (1+f)] - 1$$

Where, RINT = real interest rate.

r = nominal interest rate.

f = inflation rate.

were generally positive only in 1972, 1982 and 1985. In 1973, only lending rates exhibited positive real values. The positive real interest rates in 1972, 1982 and 1985 were, partly, a result of the rapid deceleration of inflation rate in these years.

Table 3

REAL INTEREST RATES IN NIGERIA, 1970-1985
(Percentages)

Year	Rediscount Rate	Treasury Bills Rate	Deposit Rates		Lending Rates		Inflation Rate
			Savings Deposit	Max. Term Deposit	Minimum	Maximum	
1970	-8.2	-8.6	-9.5	-9.1	-6.0	-1.6	13.8
1971	-9.6	-10.0	-10.9	-10.0	-7.4	-3.1	15.6
1972	1.3	0.8	0.2	0.8	3.7	8.5	3.2
1973	-0.9	-1.3	-2.3	-1.3	1.5	6.3	5.4
1974	-7.8	-8.3	-9.2	-6.3	-5.6	-5.8	13.4
1975	-22.7	-23.5	-22.3	-22.3	-20.1	-18.6	33.9
1976	-14.6	-15.4	-14.2	-14.6	-12.5	-9.2	21.2
1977	-9.9	-10.8	-9.9	-11.6	-8.2	-4.7	15.4
1978	-10.0	-10.8	-10.8	-9.5	-8.2	-4.8	16.6
1979	-6.1	-7.0	-6.1	-5.6	-4.3	-0.7	11.8
1980	-3.6	-5.4	-3.6	-3.1	-2.2	1.5	9.9
1981	-12.3	-13.2	-12.3	-11.9	-11.1	-7.8	20.9
1982	1.2	0.3	0.7	1.2	2.6	5.8	7.7
1983	-12.3	-13.2	-12.7	-11.1	-11.1	-8.3	23.2
1984	-21.2	-22.3	-21.6	-21.2	-21.6	-19.1	39.6
1985	4.3	2.4	3.8	4.3	3.8	7.1	5.5

Source: Estimated from CBN Annual Reports.

Commenting on the structure of interest rates in Nigeria for the same period, Agu (1988, p.20) noted that:

...the structure of interest rates in the economy does not have any bearing to the theoretical interest rate structure as generated by the loanable funds and the liquidity preference theories. Consequently, interest rate structure in Nigeria is not a good indicator of the scarcity or availability of capital in the economy.

The extent of negative real interest rates in Nigeria is further highlighted by Table 4 which compares real interest rates in Nigeria with some countries during the 1970-80 period. Apart from Turkey and Peru, Nigeria had the highest negative real interest rates for the period.

Table 4

AVERAGE REAL INTEREST RATES IN NIGERIA AND SELECTED COUNTRIES, 1970-80.
(Percentages)

Country	Term Deposit	General Credit	Preferential Credit
Pakistan	-0.8	1.4	0.7
Morocco	-2.9	1.7	-2.7
Korea	-5.8	-2.6	-10.8
Thailand	-5.9	1.2	-5.8
Kenya	-7.9	-2.4	-5.6
Turkey	-23.0	-22.0	-23.6
Nigeria	-17.6	-12.9	-8.4
Peru	-18.1	-9.4	-21.8
U.S.A.	-1.6	0.8	—

Source: Hanson and Neal (1985, p.17).

Furthermore, the government set up some specialised financial institutions which advanced credit at subsidised interest rates to the different sectors in which such institutions operated.¹¹ The effect of these interest subsidies is to constrain the development

11. The interest rates of the specialised banks are as follows:

Structure of Subsidised Interest Rates in Nigeria, 1977-1981.

Institution	Sources of Fund	Type of Loan	Interest Rate (percentages)
1. Central Bank	CBN, Commercial/ Merchant Banks.	Loan to Government; Agric. Credit Guarantee loans.	4 - 7.5
2. Nig. Agric. and Credit Bank	Government and Foreign sources.	Loans to the Agric. Sector.	3 - 7
3. Nig. Bank for Comm. and Industry	Government and Foreign sources.	Small-scale Industry loans	5 - 7.5
4. Nig. Industrial Development Bank	Government and Foreign sources.	Industrial Sector loans	6 - 9.5
5. Federal Mortgage Bank.	Government and Foreign sources	Housing loans.	5 - 7

Note: Foreign sources are mainly from Multilateral Institutions.

Source: Annual Reports and Statement of Accounts of the banks.

of a market based interest rate structure. Supporting this view, Leite and Sundararajan (1990) argued that interest rate subsidies are obstacles to market based interest rates. Hence, they suggested that steps be taken "...to reduce interest subsidies based on an assessment of their incidence and effectiveness in redirecting resource flows" (p.6).

From the analysis of restrictive policies of the government discussed so far, a plausible inference that can be made is that it allowed the Government to finance its operations with cheap credit from the financial institutions. However, whatever may be the argument for adopting a low and subsidised interest rate policy, the fact from the evidences so far is that it often contributes to a shallow financial sector (IMF, 1990). This view was also shared by the CBN (1979, p.125) when it stated that:

The present low rates of interest in Nigeria inhibit the development of viable money and capital markets. For instance, the low rate of interest chargeable by the specialised banks — Nigerian Agricultural Bank, Nigerian Industrial Development Bank, Nigerian Bank for Commerce and Industry, and the Federal Mortgage Bank — makes it difficult for them to raise funds from the capital markets.

Low real interest rates may also lead to the misallocation of financial resources if efficiency is judged on the basis of allocation to the sector that has the highest private rate of return (Oyejide and Soyibo, 1987). Moreover, financial markets, imperfect as they are in the first place, are further distorted by negative real and subsidised interest rates with adverse effects on the operational and allocative efficiency of financial institutions. The restriction on financial institutions through the imposition of high reserve requirements is examined next.

4.2 Reserve Requirements

Reserve requirement is another policy by which the government, through monetary authorities, restricted the operations of financial institutions before financial reforms. The primary objective of reserve requirements is to regulate the level of bank deposits and, thus, the level of bank assets. A secondary, albeit important, intention is the maintenance of sufficient liquidity to ensure bank solvency. Therefore, like interest rates, reserve requirements are usually organised in such a way as to enable the central bank control banks' liquidity and influence their credit operations.

In Nigeria, there are three levels of reserve requirement. The first is the primary reserve requirement which seek to control the level of bank advances in relation to the level

of cash balances. Second is the liquid assets reserve which is aimed at influencing the asset composition of the banking system and finally the supplementary reserve which could be used in conjunction with the two reserves¹².

The CBN is authorised to penalise any institution that flouts these reserve requirements by levying them and prohibiting them from extending new loans and advances or from undertaking investments. However, despite these penalties, banks still fail to comply with the requirements, as will be shown later, because the interest rates on the reserves are too low which tend to reduce their incomes.

For example, during the period, the highest interest rate the CBN can pay on special deposits is one percent below the treasury bill (TB) rate. Therefore, in 1985 when the TB rate was only 8 percent the CBN will pay only 7 percent as interest on such deposits compared to 13 percent the banks would obtain on their non preferred sectors loans.

Table 5 presents the reserve requirements on commercial bank deposits during the 1975-1986 period. The prescribed cash ratio for the different category of commercial banks ranged between 2 and 12.5 percent. The liquidity ratio for commercial banks remained at 25 percent throughout the period.

However, the total cash reserve ratio which stood at 34.5 percent during the 1975-81 period decreased to 14 percent in 1982 and 1983, increased slightly to 19.5 percent in 1984 and thereafter increased to 31.5 percent in 1986. Total reserve requirements declined from 68.5 percent in 1975 to 40.4 in 1982 due to the high liquidity resulting from the oil boom during the period. Actual reserve requirements, however, increased significantly during the 1983-86 period, varying between 63.4 and 57 percent respectively.

Reserve requirements and interest rate ceilings are the major implicit taxes on the financial sector which provide revenue to the government. This could have accounted for their extensive use as monetary policy instruments in the economy. From Table 6, revenues from reserve requirement and interest ceilings were highest in 1982 and 1983. The revenue from these implicit taxes increased from = N = 282 million in 1981 and peaked at = N = 3,011.8 million in 1983 but declined thereafter to = N = 255.8 million in 1986.

Such revenues averaged 2.8%, 25.5% and 30.3% of GDP, mobilised deposits of banks and the government budget deficit respectively during the 1981-86 period. The increase

12. The detailed characteristics of these reserve requirements have not been discussed here since they are well articulated in Nwankwo (1980, 1981), Fakiyesi (1984) and Falegan (1987).

Table 5

RESERVE REQUIREMENTS OF COMMERCIAL BANKS, 1975-86.

(Percentage of deposits)							
Year	A	Bank Classification		D	Total Cash Ratio	Liquidity Ratio	Actual Reserve Requirement
		B	C				
1975	12.5	10.0	7.0	5.0	34.5	25.0	68.5
1976	12.5	10.0	7.0	5.0	34.5	25.0	58.1
1977	12.5	10.0	7.0	5.0	34.5	25.0	52.7
1978	12.5	10.0	7.0	5.0	34.5	25.0	38.7
1979	12.5	10.0	7.0	5.0	34.5	25.0	45.1
1980	12.5	10.0	7.0	5.0	34.5	25.0	47.6
1981	12.5	10.0	7.0	5.0	34.5	25.0	38.5
1982	5.0	4.0	3.0	2.0	14.0	25.0	40.5
1983	5.0	4.0	3.0	2.0	14.0	25.0	63.4
1984	12.5	4.0	4.0	2.0	19.5	25.0	52.1
1985	12.5	10.0	7.0	2.0	31.5	25.0	67.5
1986	12.5	10.0	7.0	2.0	31.5	25.0	57.0

Notes:

Bank Group	Amount of Relevant Deposit
A	= N = 300 million and above
B	= N = 100 - 300 million
C	= N = 30 - 100 million
D	Less than = N = 30 million

Source: CBN; Annual Monetary and Credit Guidelines.

Table 6

REVENUE FROM RESERVE REQUIREMENTS AND INTEREST RATE CEILINGS IN NIGERIA, 1981-86.

Year	1 Revenue from Reserve Req. & Int. Ceilings	2 1 as % of PSBR	3 1 as % of Deficits	4 1 as % of Deposits	5 1 as % of GDP
1981	282.8	1.9	5.9	2.7	0.6
1982	2,901.0	23.9	44.6	49.9	6.1
1983	3,011.8	27.3	50.2	58.1	5.7
1984	1,342.3	14.5	49.1	24.4	2.3
1985	1,191.3	19.9	29.4	13.5	1.8
1986	255.8	2.0	2.8	4.1	0.4
1981-86	1,497.6	14.9	30.3	25.5	2.8

Note: Column 1 figures are in Million Naira values.

Source: CBN; Economic and Financial Review, various years.
Chamley and Honohan (1990, p. 39).

in revenue from reserves and interest ceilings can be attributed to the rapid fall in government revenues from oil during this period, thus further confirming earlier observations on the use of the financial sector for financing Government deficits. Selective credit controls, another instrument of financial restriction, is considered in the next sub-section.

4.3 *Selective Credit Policy*

Selective credit policies are designed to channel credit to priority sectors, groups, or regions at subsidised low rates of interest. They are usually in the form of administrative directives for allocating investible funds to priority investment projects that the government feels might not be undertaken at higher interest rates (Fry, 1988, p.398).

The objectives of selective credit policies are generally to stimulate investment in priority activities and also to redistribute income and wealth in the economy. As in most developing countries, these considerations must have influenced the use of this monetary policy instrument in Nigeria. However, the Central Bank of Nigeria did not introduce selective credit controls as a tool of monetary policy in its early years. Rather, it relied on moral suasion to make banks comply with government credit objectives.

In the view of CBN, moral suasion was ineffective in persuading financial institutions to extend credit for the implementation of government policies.¹³ According to Nwankwo (1981, p. 116), an executive director of CBN at that time, this was because of the problem of monitoring compliance by financial institutions since moral suasion cannot be quantified. Nwankwo argued that, it can only be effective where there are few institutions to be persuaded. Therefore, the CBN's feeling that moral suasion was ineffective and the Government's wish to influence the pattern of economic development led to exclusive use of selective credit policy by CBN since 1969.

Credit guidelines are usually articulated in the annual monetary policy circulars of CBN and it directs the banks as to the quantity, the direction and the cost of money and credit in the economy. The characteristics of selective credit policy in Nigeria include absolute ceilings, sectoral allocation, and interest rate stipulations. Absolute ceilings on the growth of banking credit was introduced and removed in various times between 1964 and 1976/77 but has remained a regular policy tool since then.

13. This policy was used by the government during the implementation of the indigenisation programme. However, the Fourth Plan commented on the ineffectiveness of moral suasion, especially with respect to loans to agricultural sector and small scale enterprises. See Fourth National Development Plan (1980-85), pp.9-12.

For the purpose of the ceilings, banks are classified into big and small banks to account for differences in their liquidity position. However, there was no distinction between banks with respect to credit ceilings until the intensification of restriction measures in 1977. The limit on the expansion of credit by banks increased from 10 percent of deposits in 1970 to 20 percent in 1971. The ceiling was reduced to 8.4 percent in 1972 but was again increased to 40 percent in 1976.

From 1978, limits on credit by the big banks were reduced to 30 percent. The ceilings remained at this level till 1982 when it was reduced to 25 percent and stood at 7 percent as at 1985. For the small banks, the ceiling remained at 40 percent in the 1978-82 period. The ceiling was reduced from 40 percent in 1977 to 35 percent in 1982 and to 10 percent in 1985.

Sectoral allocation is another feature of credit policy in the country. Within the absolute credit ceilings discussed above, financial institutions are usually directed to grant more credit to the preferred sectors than less preferred sectors. Each of these sectors is further divided into activity sectors with specific percentage allocations prescribed.¹⁴ While credit allocation for the preferred sectors are regarded as minima, that for the less preferred sectors are maxima.¹⁵ Sometimes selective credit controls are based on ownership status of private investors, that is, indigenous and foreign. This was the case before the nationalisation of foreign banks in 1976. The aim was to encourage more credit to indigenous enterprises.¹⁶

Furthermore, the credit controls are flexible in terms of the institutions at which they are directed. At first it was limited to the commercial banks. In 1976, it was extended to the merchant banks, and to the insurance companies in 1978. In addition, certain

14. Preferred sectors include production, service, exports (included in 1980) and development finance institutions (included in 1981) while less preferred sectors include general commerce and others not classified as preferred sectors. However, the classification of these sectors change from time to time depending on the thrust of government policy. For example, in 1986 there were 18 different sectors covered by credit guidelines but these had been reduced to only two by December, 1989.

15. For instance, the 1981 Monetary Policy Circular stipulated the minimum credit for the preferred sectors as 75% while the maximum for the less preferred sectors was 25% of total credit granted by the banking institutions.

16. The CBN found in a survey of lending practices of banking institutions that expatriate banks granted on the aggregate only about 25% of their loans and advances to indigenous borrowers. This finding prompted the CBN to make a policy that average lending to indigenous borrowers by all banks should not be less than 35% of their loan portfolio. This percentage was increased to 40% in 1973 and to 70% in 1979. See Nwankwo, 1981, pp.117-118.

activities are often excluded from the policies. For example, loans granted for the purchase of businesses under the second phase of the indigenisation programme were excluded from the aggregate credit ceilings.

The use of selective credit controls by the CBN seemed to be effective until the early 1980s essentially due to the availability of oil revenues.¹⁷ Through selective credit policy, bank loans and advances were redirected to the productive sectors at subsidised interest rates. The share of these subsidised loans in total credit to the economy are shown in Table 7.

Table 7

SHARE OF SUBSIDISED CREDIT IN TOTAL BANK CREDIT, 1975-1986

Year	(Percentages)		
	Commercial Banks	Merchant Banks	Total Banking Sector Credit
1975	54.0	—	51.6
1976	62.1	60.0	59.1
1977	45.3	48.2	61.3
1978	64.1	61.5	70.0
1979	68.7	62.8	67.6
1980	68.8	63.1	69.4
1981	68.5	64.3	68.6
1982	67.2	68.8	68.1
1983	65.5	70.4	66.8
1984	66.2	59.4	64.8
1985	67.9	61.4	67.0
1986	65.8	61.9	65.2

Source: Computed from CBN Statistical Bulletin, vol. 1, nos 1 & 2, 1990.

17. The Fourth Development Plan (1980-85, p.10) attests to the success of selective credit in the 1970s when it stated that "the CBN succeeded by and large in making the commercial banks follow the lines mapped out in the guidelines". However, the evaluation of the policy in respect of the agricultural sector discussed later in this section does not support this claim (see Table 8).

The percentage of subsidised loans in the portfolio of commercial banks increased from 54 percent in 1975 to 62.1 percent in 1976 but declined to 45.3 percent in 1977. Subsidised loans by commercial banks increased again to 64.1 percent in 1978 and consistently but erratically increased to 65.8 percent in 1986. The annual average of Commercial banks subsidised loans during the period was 63.7 percent.

The subsidised loans portfolio of merchant banks increased from 60 to 70.4 percent between 1976 and 1983 before declining to 61.9 percent in 1986. The annual average of subsidised loans in the portfolio of merchant banks was 68.4 percent. Similarly, the share of subsidised loans in the total banking sector's credit to the economy increased from 51.6 percent in 1975 to 65.2 percent in 1986, with an average of 65 percent for the period.

The effect of these subsidies is that it distorts credit allocation by promoting cross-subsidisation between groups of borrowers. That is, financial institutions recoup losses arising from mandatory lending at concessional interest rates on the relatively better off (and often more economically efficient) sectors of the economy.

4.3.1 *The Effectiveness of Selective Credits*

An important element in evaluating the effectiveness of restrictions on credit allocation is to consider what criteria the monetary authority employed for credit allocation and whether these criteria are optimal and rational. Although the authorities have not explicitly specified the set of criteria underlying credit guidelines in Nigeria, it is not difficult to imagine that the criteria are not influenced solely by economic efficiency but sometimes largely by social and political considerations and the development strategy of the Government. According to World Bank (1983a, p.47), since the Government attempts to achieve a multiple of often conflicting economic objectives, it is almost impossible to judge either the rationality or optimality of credit allocation criteria in the country.

Therefore, in this paper, the effectiveness of the credit guidelines has been examined by analysing whether financial institutions complied with the sectoral credit allocation guidelines. This is very important from the policymakers's point of view since the Government is not interested in the sectoral credit allocation *per se* but in effecting the allocation of physical resources within the economy (World Bank, 1985, p.23). Therefore, the compliance of commercial banks with respect to prescribed credit ratios to the agricultural sector has been used for this analysis.

The agricultural sector was selected because it is one of the preferred sectors to which the banks are expected to be generous in credit allocation, especially through the Agricultural Credit Guarantee Scheme (ACGS). The ACGS scheme was launched in 1977 to boost agricultural lending by commercial banks. The scheme guarantees up to 75 percent of a loan granted by banks for agricultural purposes.¹⁸

Table 8 presents the analysis of commercial banks compliance with credit guidelines to the agricultural sector in the 1975-85 period. From the Table, credit allocation to the agricultural sector by commercial banks increased from 2.4 to 10 percent in 1975 and 1985. However, commercial banks met the prescribed target by the monetary authorities only in 1979 during the period. Similarly, the merchant banks achieved prescribed credit targets to the agricultural sector only in 1985. The average shortfall in prescribed credit allocation to the agricultural sector for the period were 14.1 and 29.4 percent for commercial and merchant banks respectively.

Table 8

PERFORMANCE OF COMMERCIAL AND MERCHANT BANKS UNDER THE CENTRAL BANK CREDIT GUIDELINES IN NIGERIA, 1975-85.

Year	Share of Agric. in Total Loans (%)		Prescribed Minimum loan to Agriculture (%)		Variation from Prescribed Minimum (%)	
	Commercial	Merchant	Commercial	Merchant	Commercial	Merchant
1975	2.4	1.0	6.0	6.0	-60.0	-83.3
1976	3.8	1.7	6.0	6.0	-36.7	-11.7
1977	4.5	2.9	6.0	4.0	-25.0	-27.5
1978	5.5	2.7	6.0	4.0	- 3.3	-32.5
1979	7.1	3.4	6.0	5.0	+ 18.3	-32.0
1980	7.3	4.9	8.0	5.0	- 8.8	- 2.0
1981	6.9	4.0	8.0	5.0	-13.8	-20.0
1982	7.7	3.9	8.0	5.0	- 3.8	-22.0
1983	8.5	3.7	10.0	5.0	-15.0	-26.0
1984	9.1	4.7	10.0	5.0	- 9.0	- 6.0
1985	10.8	6.7	12.0	6.0	-10.0	+ 11.7
1975-85	6.7	3.6	7.8	5.1	-14.1	-29.4

Source: Computed from CBN Annual Reports and Statement of Accounts, various issues.

18. The performance of the Agricultural Credit Guarantee Scheme has been widely studied and, in most cases, the conclusion has been that it is an inefficient way of financing agriculture in Nigeria. See Olomola (1992) for further details on this subject.

The analysis above has shown that, despite penalties, banks still ignore credit guidelines and allocate their resources to sectors with a higher expected rate of return.¹⁹ According to the World Bank (1985) the banks were unwilling to identify creditworthy small farmers due to the perceived riskiness of lending to such farmers. Hence, agricultural credits meant for mainly small farmers, were allocated mostly to large or "portfolio" farmers.

Therefore, the outcome of credit allocation via guidelines in Nigeria was consistent with the view that selective credit guidelines are not an optimal means of allocating financial resources in developing countries [Fry (1988, pp.410-418); World Bank (1989a, p.129)]. The inherent inconsistencies of the guidelines usually serve to defeat the very objectives for which they are designed.

In sum, the directed credit policies of the government, which ensured the availability of credits to itself, constrained efficient allocation of financial savings by financial institutions before reforms. While there are still some credit controls, the reduction in the number of sectors to which credits are directed from 18 before reforms to only two after reforms (in 1991) should improve credit allocation by financial institutions in the country.

5. Concluding Remarks

This paper analysed the restrictive financial policies of the government which imposed considerable constraints on the development of the financial sector during the study period. The policy instruments employed by the government facilitated the effective use

19. This problem was highlighted by the CBN (1979, p.127) in its appraisal of 20 years of CBN when it stated that "a problem facing monetary management that should be mentioned here is the shortcomings of the most popular instrument of monetary regulation in Nigeria — Credit Guidelines. Apart from the fact that the banking system failed on a number of occasions to attain full compliance with the various CBN credit guidelines, the problem of "window dressing" the figures for their credit operations cannot be ignored. More importantly, there is the problem of inability to control the ultimate use of borrowed funds. The mere prescription of a sectoral distribution of credit may not ensure that funds borrowed for production cannot be applied for consumption". The foregoing observations of the CBN were further confirmed by the World Bank (1983a, p.48) when it found a high degree of fungibility at the lenders' level while borrowers allocate their borrowed funds to different uses with or without the knowledge of the banks. The World Bank then concluded that "intersectoral shifts of credit by end users may have actually led to much smaller allocation of credit to the agricultural sector than recorded" (p.49).

of the financial sector to finance government borrowing requirements. Hence, interest rates were restricted which resulted in implicit interest rate subsidies. Also, high reserve requirements were imposed on financial institutions which enabled the government to use financial savings at low costs. Both reserve requirements and low interest rates, which are implicit taxes, were used to extract revenue from the financial institutions in addition to explicit taxes (e.g. corporate income tax) levied on the institutions.

Although selective credit policy was aimed at making credit available to the priority areas of the economy, the inherent inconsistencies in the policy made the achievement of this objective difficult. Credit allocation, especially to the agricultural sector, was far less than the stipulated annual credit guidelines. This was largely due to the unwillingness of banks to lend to farmers at subsidised rates and the absence of adequate mechanism for monitoring compliance by monetary authorities.

Finally, the analysis presented in this paper reveals that restrictive financial policies imposed considerable constraints on the performance of financial institutions prior to financial liberalisation. This, makes financial liberalisation, which relies on less direct regulation of financial institutions, a probable alternative strategy for improving financial sector performance in the country.

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Abstract

The recent emphasis on financial liberalisation, in academic and policy circles, have overshadowed the analysis of the restrictive policies that led to the call for financial reforms in developing countries. This paper discusses restrictive financial policies in Nigeria, prior to reforms, to highlight the rationale for the recent liberalisation of the financial sector as part of the structural adjustment programme in the country.

In the paper, financial restriction or repression was not viewed in the narrow sense of interest rate repression but also to include the captive use of the financial sector for financing government budget deficits, restricted ownership of financial institutions, high reserve requirements and pervasive government intervention in financial savings allocation. The paper concludes that given the plethora of these restrictions, which are often discretionary and inconsistent, financial liberalisation, with less direct controls on the financial sector, offers a probable alternative strategy for promoting the effective operations of financial institutions and hence, the deepening of the financial sector in Nigeria.

