PROBLEMS OF MONETARY MANAGEMENT IN NIGERIA WITH PARTICULAR REFERENCE TO MONETARY POLICY AND FOREIGN EXCHANGE MANAGEMENT

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2. Introduction

Monetary management involves the management of money supply in the economy and encompasses cash management, foreign exchange management, international liquidity, interest rate policy, the gamut of monetary policy instruments, the capital market, indirectly wage and salary management etc. The later is more appropriately in the province of fiscal policy but since its impact effects the volume of money supply in circulation it has implications for monetary management.

In this paper we will be more concerned with the problems of monetary policy and foreign exchange management in the Nigerian economy. Monetary policy is the appropriate use of official instruments in order to influence financial flows with the aim of ensuring an optimal constellation of output, employment, inflation, balance of payments etc.[1] The two major tools of Government market intervention are monetary and fiscal policies both used to achieve the objectives of the state. while fiscal policy deals with Government tax and expenditure programmes, monetary policy is charged with regulating volume, direction and price of money supply and credit conditions in the economy.[2]

Instruments of monetary policy include the quantitative instruments like discount rate, interest rate, open market operations, reserve requirements, variable liquid asst ratios, stabilisation securities and the qualitative instruments like moral suasion and selective credit controls or guidelines.

The discount rate is the rate of interest the Central Bank charges the commercial banks on loans extended to them. Sometimes it is

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charged to follow movements in interest rates at home and abroad. The discount rate once set, influences the battery of interest rates in operation in the economy as the various interest rates maintain their respective differentials with the discouct rate. If monetary authorities wish to reduce liquidity in the economy they may increase the discount rate thereby increasing the cost of borrowing and reducing investments. If monetary authorities intend to increase liquidity and increase production, they reduce the discount rate and borrowing becomes more attractive.[3]

The interest rate is both a price of capital to the borrower and a return on capital to the saver or lender.[4] An increase in interest rates increases savings and time deposits and decreases the money supply which consists of currency and demand deposits. Increase in interest rates has a favourable impact on balance of payments. Firstly as interest rates increase aggregate spending falls and therefore national income and imports do not increase as much. Secondly, the increase in interest rates may give rise to increased net capital inflow. Interest rates were first used as instruments of monetary policy in Nigeria between 1959 and 1962 as a means of repatriating short-term funds from abroad to Nigeria. At first, Nigerians were investing their surplus capital abroad until favourable interest rates induced their repatriation

Open market operations involve the buying and selling of government securities by monetary authorities to commercial banks and the general public. Open market purchases increase commercial bank reserves. This results in a large money supply which has an expansionary effect on the economy. Open market sales decrease commercial bank reserves and has the ultimate effect of reducing money supply. Open market operations have not been used in Nigeria, due mainly to the under-development of the Nigerian money and capital markets.[5]

The reserve requirements otherwise known as the reserve ratio can be manipulated by the monetary authorities to either increase or reduce the ability of commercial bank to make loans to the public by simply increasing or reducing the ratio. When reserve requirements increase, money supply falls and when they decrease, money supply increases. Another effect of changes in reserve requirements is that a change in the required ratio changes the ratio by which the banking system can expand credit through the multiplier effect. If the required reserve ratio increases, the money multiplier decreases thereby reducing the liquidity position of the banking system. Cash reserve requirements

were first used in Nigeria between 1972 and 1976 to reduce excess cash holdings by commercial banks.

Other instruments of monetary policy are variable liquid asset ratio, wherby commercial banks are required to diversify their portfolios of liquid asset holdings, stabilization securities/special deposits in which the Central bank may require financial institutions to keep special deposits or buy special securities from it. These instruments are no longer in use in Nigeria. Moral suasion simply means the employment of friendly persuasive statements, public pronouncements or outright appeal. While selective credit control is a procedure whereby the monetary authorities tend to favour some sectors of the economy than others in the allocation of credit. This is the most important instrument of monetary policy in use by the Nigerian Central Bank. The Central Bank has continuously issued a number of guidelines since 1969 with the objective of channelling commercial bank loans to the productive sectors of the economy.

As Uzoaga has shown[6], the quantitative instruments of monetary policy are devices to effect changes in the primary reserve positions of commercial banks while the qualitative or selective instruments restrict the availability of bank credit rather than the bank's capacity to create and extend loans. Thus the quantitative instruments are more likely to have the ready impact effect on money supply aggregates than the qualitative instruments. In consequence in this paper we should be more concerned with the quantitative instruments of policy.

Foreign exchange management relates to the strategy utilised in effecting balance of payments equilibrium. The important variables in this regard include exchange rates, prices, incomes, controls and interest rates. The exchange rate is the price of foreign currency in terms of domestic currency. Since the demand and supply of foreign currency determines the exchange rate, it follows that there is a particular equilibrium exchange rate at which the foreign exchange market is in equilibrium. Thus at this appropriate exchange rate. the balance of payments is in equilibrium. The problem of foreign exchange management is the determination of this exchange rate through the depreciation or appreciation of the currency in other to engender equilibrium, The operation of the second tier foreign exchange market (SFEM) in Nigeria does not seem to provide a practical solution to this problem although in theory it is supposed to help realize the true value of the naira and effect a balance in the external sector.

3. The Problem Areas

The problems of monetary management with particular reference to monetary policy and foreign exchange management in the Nigerian economy include the following (a) inadequacy of monetary instruments (b) under development of the money and capital markets (c) low interest rate structure (d) slow monetary transmission system (e) the effect of stagflation in the Nigerian economy (f) restrictionary nature of externally imposed credit ceilings, (g) inadequacy of money supply in relation to Gross national product and (h) inefficient guidelines by the Central Bank in the [foreign exchange market (SFEM)*. The above is not supposed to be an exhaustive itemization of the problems but a selective one.

(a) Inadequacy of Monetary Policy Instruments

Among the monetary policy instruments itemised only a few viz : discount rate, interest rate, reserve requirement and selective credit guidelines are in use in Nigeria. The other quantitative and qualitative instruments have not been admitted to the battery of available arsenal for the pursuit of the objectives of state. As a result the impact effect of policy is weakened aud the resultant target objectives cannot then be easily realised.

The availability of monetary policy instruments affect both the speed and effectiveness of realization of policy objectives. For instance if the objective is to reduce money supply, restrictionary policy measures are put in place. The number of instruments that can be manipulated by policy makers if adequate would be reinforcing in quickly achieving the desired objectives. But if inadequate, the desired objectives could only be approximated or met after a long time lag reducing the effect of policy.

For instance, open market operations undertaken as a deliberate policy with the primary objective of influencing the cash base and lending power of commercial banks and the rest of the financial system have never been undertaken by the Central Bank of Nigeria[6]. Other instruments not in use are variable liquid asset ratios, stabilization securities and the qualitative instrument like moral suasion. The Central Bank is more keen to use the force of its powers to regulate credit through selective controls than to use persuasive pleas

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*The second tier foreign exchange market is a floating exchange market for Nigerian currency (Naira).

through moral suasion to achieve the same result. Since Nigeria is not yet a disciplined society despite WAI* and NOM**, the use of selective controls with penalties for non-performance seem to be in order. The variable liquid asset ratio has not been varied since 1962 when it was set at 25%.

(b) Non-development of the Money and Capital Markets

One of the reasons for the refusal or inability of the Central Bank of Nigeria to use open market operations for monetary control is the absence of developed money and capital market[7]. The money market acts as the principal buyer of Government securities and when it is not developed it cannot absorb the series of securities released by Government or the Central Bank and cannot then perform the role required of it to control liquidity. For instance many banks (mainly merchant banks) have been known to refuse deposits because of the lack of investment outlets for such funds[8]. Thus the non-development of money and capital markets reduces investment outlets both for short term and long term funds and as such to that extent reduces the effectiveness of monetary policy. There could be condierable liquidity even when contractionary policy measures have been taken, so that stabilization measures are seriously weakened.

(c) Low Interest Rate Structure

The operating interest rates are low and when combined with the rate of inflation are indeed negative. As a result there is an excess demand for loanable funds and the operating interest rates do not equate the supply and demand for loanable funds. Low interest rates means reduced savings and reduced investment funds, but the marginal efficiency of investment is enhanced working through the discounted value of future investment incomes. As investment funds are reduced, investment prospects are enhanced creating distortions in the capital market. Interest rates should be allowed to vary to equate the demand and supply for loanable funds and serve as a viable instrument of monetary policy. When liquidity is tight, interest rates should be high and when liquidity is high, interest rates should be low working through the impact of money supply on the interest rates. Also low interest rates have a negative impact on balance or payments and high rates have a positive impact as they attract short term capital.

*War Against Indiscipline.

**National Orientation Movement.

(d) Slow Monetary Transmission System

It has been shown that the clearing time for checks is unnecessarily long in Nigeria[9]. It takes days for checks issued within the same city to clear and months for the process to work out for cheques issued for outside city banks. This is because of the paucity of the Central Bank's clearing houses which are additionally unmechanised and the absence of adequate communication system. For instance inter city telephone services are present but non-effective. The lines are few, consequently often congested and susceptible to frequent breakdowns.

Letters travel very slowly and telegrams have the same pace. The transfer of accounts from one bank office to the other may take weeks. It takes time to obtain the necessary information about a customer's credibility. Access to banking services, increased bank awareness and reduced transactions cost are militated against by bad infrastructural/communication system in Nigeria. Economies with established and well developed markets achieve speed in the transmission of information through the establishment of reliable tetephone communication net works, utilization of electronic data storage capacity from where reliable information can be recalled. In Nigeria, the problems of irregular electricity supply, poor telephone, posts and telegraph services, and the general inadequacy of the transport system makes it impossible to reach the level of communication efficiency attained in more developed circumstances and in consequence monetary management through intermediation processes suffers.

Recently an American tourist could not cash a traveller's cheque in Warri because according to the bank official he (the bank official) did not know what exchange rate to use in cashing the cheque. Said he "the rate will change by the time the cheque will arrive in Lagos and if it goes down, we do not want to lose"[10]. Lagos is not more than 300 miles away from Warri. This type of attitude increases patronage of the black market and Nigeria's foreign exchange problems would persist.

(e) The Effect of Stagflation in the Nigeria Economy

In a period of depression, monetary policy should work towards stimulating the economy in an expansionary direction. Thus in this situation an expansionary and not a restrictionary monetary policy is called for. But an expansionary monetary policy would exacerbate the inflationary spiral in the economy and worsen the balance of payments position.

In the Nigerian situation, the economic recession which was triggered by the oil glut of the early 1980's also manifests symptoms of inflation, unemployment and deficit disequilibrium. The peculiar Nigerian case has been aptly described by Professor Swamy as that of stagflation, the prevalence of inflation and unemployment. Thus the Nigerian situation requires the sacrifice of some objectives of state in order to attain the other objectives. A restrictionary policy would be conducive to price stability and external balance, but would conflict with the attainment of the important objectives of full employment and economic growth[11].

The above conflicts result from the fact that the manifestations of the business cycle in the Nigerian situation do not point to one direction, a boom economy or a recessionary economy. The manifestations show symptoms of the two rising prices and massaive unemployment. There is then the need to sacrifice some objectives in order to attain the others, thus the problems of choice of objectives to attain and those to sacrifice. The present choice of restrictionary policies would help attain price level stability and balance in the external sector, but would worsen the problem of unemployment and negative economic growth.

(f) Restrictionary nature of externally imposed credit ceilings

Under the I. M. Fs. enhanced surveillance scheme through which Nigeria rescheduled much of her external debts which fell due for payments some performance criteria were imposed on Nigeria by the I. M. F. Some of the imposed criteria include an upper limit of $ 2 billion on the country's ability to contract fresh foreign borrowings, restriction of the growth of domestic credit to 7.6% for the four months to end 1986 and 4.4% for 1987 and restrictions on loans and advances to the government sector not to exceed 7.4% during the four months ended 1986 and 1.5% for 1987 e.t.c.[12]. The performance criteria thus imposed a restrictionary monetary policy in Nigeria and is linked to the tight liquidity position the nation is now in. Since the present situation does not allow reasonable elbow room for banking institutions to increase loan accommodation ro enterpreneurs for both circulating and fixed capital assets, the economic rescuscitation of the nation is harmstrung. The externally imposed ceilings are geared to achieving in the external sector and price level stability but would worsen the problem of unemployment and negative economic growth.

(g) Inadequacy of Money supply in relation to G. N. P.

The money supply in relation to G. N. P. was 18.7% in 1981, 19% in 1982 and 1983 respectively and 22.6% in 1985[13]. In contrast to these low rates, in developed capitalist countries of Europe and America rates of between 30% to 40% are realized. This shows the low base of money supply in the Nigerian economy and the cosequent tight liquidity has been responsible for low growth rates, massive unemployment, reduced capacity utilization in plants and poor agricultural production.

Table I

G. N. P. (N'000)

	1981	1982	1983	1984	1985
1. at Market prices	52.18	54.50	53.99	55.59	58.73
2. at 1977-78 factor cost	29.91	29.19	27.36	25.85	26.47
3. %variation over preceding year at market prices	—	4.4	−0.9	3.0	5.6
4. %variation over preceding year at 1977 factor cost	—	0	−8.5	−5.5	2.4

Source : *Nigerian Journal of Financial Management* Vol 4, Nos 1—2 1985 P IX.

As shown in table I the real rate of growth of G. N. P. has consistently been negative except for 1985. There is evidence that the growth rates in 1986 and 1987 followed the same negative pattern. For a nation needing to move itself from a depression, a restrictionary monetary policy combined with low level of money supply would tend to perpetuate the depression. Tight liquidity will not bottom off the though of economic recession and launch the nation on a path of self sustained expansionary momentum. There is then need to increase money supply which would in turn increase effective demand and set up the necessary multiplier effects that would be sufficient to revitalise the economy from its present depressed situation. Increased money supply could be used to finance small scale cottage industries, agriculture and in funding institutions like Anambra State University of Technology (ASUTECH) and firms faced with serious cash flow problem.

(h) Inefficient guidelines of the Central Bank in the Second tier Foreign Exchange Market (SFEM).

Nigeria now uses a floating foreign exchange market the second tier foreign exchange market (SFEM) to determine the exchange rate

of its naira currency. In the regime of float which is now in operation the Nigerian naira has depreciated by more than 300% from its pre-SFEM parity. One of the objectives of SFEM is to attain a true value of the naira currency and thus the correct exchange rate to establish equilibrium in the external sector and reduce or completely checkmate the erstwhile deficits in the nation's balance of payments which had led to high external indebtedness in the past regime of fixed parities.

The Central Bank of Nigeria has power to intervene in the market to prevent unnecessary violent fluctuations and maintain some degree of stability. Evidence abounds that the Central Bank has intervened unnecessarily to the extent that what we now have is not a market determined exchange rate but a quota based exchange rate which would not conduce to external equilibrium. The demand side of the market has been effectively reduced by Central Bank guidelines assigning quotas of available foreign exchange to banks depending on their size and deposit liabilities. Since the demand side is effectively reduced by this maximum trading quota's the exchange rate that is determined is a shade less than the real market exchange rate hence the over valuation of the naira continues to a degree along with its untoward consequences. These untoward consequences include black marketeering, naira trafficking, over-invoicing of imports, under-invoicing of exports e. t. c. These would hinder the establishment of external equilibrium and eventual disappearance of payments deficit. Thus the principal objective of SFEM is defeated.

4. Recommendations and Conclusions

It is hereby recommended that the Nigerian money and capital markets be further developed and monetary policy instruments further widened to effect speed and efficiency in the attainment of the objectives of state. The further development of money and capital market will help in creating outlets for investment of both short term and long term funds by banks insurance companies and other financial institutions. For instance the stock exchange has few securities listed and new issues are often over subscribed. The banks do not have outlet for investment of short term funds over-night to the extent that the banking system suffer from over liquidity even in the face of seriously contractionary monetary policy. Thus policy objectives are not met with precision with the underdevelopment of Nigerian money and capital market. Further development of the market will make possible the use of additional policy instruments like open market operations, variable liquidi asset

ratio (which had remained fixed since 1982) moral suasion, stabilization securities e. t. c. in attaining the objectives of state.

The low interest rate structure whose real magnitudes are negative because of the impact of inflation should be reviewed to enable monetary policy operate with greater efficiency. Reasonably high interest rates correlate with restrictionary monetary policy to establish price level stability and external balance. High interest rates also attract short term capital from abroad in search of high returns on investments. Interest rates should be allowed to vary in response to the demand and supply forces for loanable funds to help achieve state objectives automatically without discretionary manipulation by state agents.

Banks should increasingly mechanise their processes and the Central Bank clearing system should be improved to shorten clearing time for cheques. Efforts should additionally be made to improve society's infrastructnral equipment to enhance speed in the transmission of information. Telephone services, telegrams and mail delivery systems should be improved upon to give efficient infrastructural support base to the financial system and the economy as a whole. Improvement of the infrastructures including electricity will enhance speed and reliability in monetary transmissions and financial intermediation -proceses in the economy.

The effect of stagflation in the economy means that some policy objectives should be sacrificed in order to attain the other more desirable objectives. It seems to me the Government has wrongly chosen price level stability and external balance as the desirable objectives of state policy. It is to be recommended that in view of the economy's depressed situation that this choice would tend to perpetuate the depressed economic situation. Expansionary monetary policy should be favoured to accelebera te economic growth and substantially reduce unemployment so that the economy is turned around from the bottom of the business cycle.

The externally imposed restrictionary ceillings on money supply and credit accommodation to Government should be ignored. This would be consistent with the need to reflate the economy from its depressed situation.

Since money supply in relation to the Gross national product is too low and falls short of ratios attained overseas, and in the face of massive unemployment of human and material resources it is additionally recommended for substantially increased money supply. It is

possible to increase money supply substantially without inducing an inflationary spiral if the increased supply is used to increase productivity in both the agricultural and industrial sectors to re-activate dormant facilities.

Lastly the Central Bank guidelines stipulating percentage buying quotas for banks in the 2nd tier foreign exchange market should be discontinued so that the true value of the naira is achieved and the untoward practices in the foreign trade sector completely checkmated. These practices like black marketeering, naira trafficking, bad invoicing of exports and imports seem to persist because the true value of the naira has not yet been attained.

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