ECONOMIC EMERGENCY IN NIGERIA

Edited by

U.C. NZEWI

MONETARY POLICY IN A PERIOD OF DEPRESSION: THE NIGERIAN CASE

by

Dr. DON. N. IKE

Abstract

Instruments of monetary policy in use in Nigeria include the minimum rediscount rate, interest rates, reserve requirements, moral suasion and selective credit control. In the period of economic depression 1980-1986, the monetary policy instruments have been applied in a restrictionary manner in the Nigerian economy. While this would conduce to price level stability and balance of payments equilibrium, it would not help towards the achievement of the growth and employment objectives of the state. The incentive measures for agriculture could enhance agricultural productivity and absorb some of the urban unemployed. It is in this sector that the growth and employment objectives of the state could be met in the period of Nigerian depression, but this is hardly adequate to effect the necessary turnaround in the economy.

Monetary Policy and the Nigerian Situation

Monetary policy is a deliberate effort by the Government through the Central Bank to control the money supply and credit conditions for the purpose of achieving certain broad economic objectives. Among the objectives of state policy are full employment, stable prices, economic growth and balance of payments position. The two major tools of Government market intervention in the economy are fiscal and monetary policies both used to achieve the objectives of 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 in the economy.

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

In a period of depression, monetary policy should work towards stimulating the economy in an expansionary direction.

Thus monetary policy needs to be expansionary and not restrictionary. But 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 1980s also manifests symptoms of inflation, unemployment and deficit disequilibrium in the external sector. To reflate the economy and reduce unemployment would at once conflict with the goal of price level stability and balance in the external sector. Thus the Nigerian peculiar situation requires the sacrifice of some objectives in other to attain the others. A restrictionary monetary 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.[1]

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 the prevalence of the two hence the conflicts in policy and the need to sacrifice some objectives in other to achieve other major objectives of the state.

Application of Monetary Policy Instruments in Nigeria

Considering first, the quantitative instruments[2], the discount rate is the rate of interest the Central Bank charges the commercial banks on loans extended to them. Sometimes it is charged to follow movements in interest rates at home and abroad. If the monetary authorities wish to reduce liquidity in the economy, they may increase the discount rate. By doing so, cost of borrowing will increase and this action will reduce investments. If monetary authorities intend to increase liquidity and increase production, they reduce the discount rate and borrowing becomes more attractive.

The interest rate is both a price of capital to the borrower and a return on capital to the saver or lender.[3] 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 rate rises, 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 instrument 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 the 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 banks reserves and has the ultimate effect of reducing money supply. Open market operations have not been used in Nigeria due mainly to the underdevelopment of Nigeria's money and capital markets.

The reserve requirements otherwise known as the reserve ratio can be manipulated by the monetary authorities to either reduce or increase the ability of commercial banks 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 whereby 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.

The qualitative instruments are moral suasion and selective credit control. Moral suasion simply means the employment of friendly persuasive statements, public pronouncements or outright appeal. While selective credit control is a proceedure whreby 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 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.

Monetary Policy Measures

Aggregate credit ceiling on commercial and merchant banks depressed economy of Nigeria since 1980. Emphasis is being placed in the agricultural sector as a way of diversifying the economy away from the mono-cultural dimensions of oil. Sectoral allocation of commercial banks' loans to agriculture has increased to 15% in 1986 from the 8% figure of 1980.

Further, banks are now to retain 40% of deposits of rural banks for loans and investments in rural areas. Since the rural areas are all agricultural based, this as hoped would be a further boost to increased agricultural productivity. Additional incentive to farmers is the directive to commercial banks to advance up to ₦5,000 to each farmer loan applicant without security.[6] As farmers are noted to be woefully lacking of security for bank loans, this would help channel more loan finance to the agricultural sector and enhance productivity. The employment objective of state could be met only in the agricultural sector. This is hardly adequate to help reflate the economy from its depressed circumstances, as this sector already accounts for about 50% of the Nigerian labour force.[7]

Conclusions

Monetary policy measures since 1980 coinciding with the period of Nigerian prolonged recession or depression has been restrictionary. Aggregate bank advances have gone down and stabilised at 1980 magnitudes. Interest rates have gone up and cash reserve ratios have stabilised on the low figures of 1980. The liquidity ratio which has only been implemented in the breach by commercial banks is still a low figure of 25%. It is the view of the author that the battery of monetary policy measures since 1980 is restrictionary and can only conduce to external equilibrium and price level stability. The employment and growth objectives of the country cannot be met unless the agricultural sector responds to several incentive measures and absorbs the mass of the urban unemployed. The measures are thus not adequate to help revitalise the depressed Nigerian economy.

NOTES

1. Don. N. Ike, "Appraisal of Budgetary Provisions for the Revitalization of Nigerian Economy", U.C. Nzewi and E.O. Ozoh (eds.), *Strategies for Nigeria's Economic Recovery* (Oko: Anambra Polytechnic Press, 1985), pp. 32-33.

2. W. Okefie Uzoaga, *Money and Banking in Nigeria*, (Enugu: Fourth Dimension Publishers, 1981), p. 161.

3. A.O.G. Otiti, "The Concept of Money and Monetary Policy", *Bullion*, Volume 7, No. 2. (April 1982), pp. 13-18.

4. Central Bank of Nigeria, *Bullion*, Silver Jubilee edition, (July 1984), pp. 24-35.

5. Don. N. Ike, "Economic Analysis of the Revised 1984 Nigerian Budget", Mimeograph, Institute of Management and Technology, Enugu, 1984.
6. 1986 National Budget Speech Delivered on December 31, 1985.
7. *Nigerian Journal of Financial Management,* Vol. 3, No. 2 (December, 1984), p. x.