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## A Critical Understanding of the Impact of Monetary Policy on Nigerian Indigenous Firms: Lessons from Ten Years of Military Leadership, After 2nd Republic Nigeria (1983 – 1992)

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### **Abstract:**

*The contradictory activities of the Apex Bank (Central Bank of Nigeria, which was contractionary) and that of the Commercial and Merchant Banks (which was expansionary), revealed the ineptitude of the Apex Bank, or its leadership, to effectively re-direct the economy towards sustainable development. The persistent above the maximum 16% loanable funds given to small-scale indigenous firms (16% in 1983; (1985, 1986; 18.7% in 1987; 21% in 1988, 1989; 22.9% in 1990; 20% in 1991-1992) is the Achilles-Heel, the missing link in adequate macroeconomic management of the real sector productivity and employment. The resultant excess liquidity of the economy had cataclysmic effect on inflation making cost of capital expensive and thus, adversely affected Balance of Payment and employment. In all, precautions should be taken against expansionary policies as well as accretion of foreign assets (net) and other assets in the hope to actualize the policy objective.*

**Keywords:** Loanable funds, small-scale indigenous firms, productivity, inflation, economy, banks

### **1. Introduction**

Most Less Developed Countries (LDCs) of Africa, Latin America and Asia have increasingly, till date, become characterized with financial crises and debt burden. In these countries, it is not strange observing cases of high unemployment rate, low capacity utilization, domestic price instability, decreasing marginal economic growth plus other macroeconomic problems, which summed together irresistibly as Third World. Paradoxically, policy decisions directed at alleviating the macroeconomic problems enumerated above either never appreciated the significant role which the invisible hand monetary policy could play in determining the macroeconomic aggregates of the countries concerned or allowed for the operation of monetary policy in such a haphazard manner that ultimately confounded whatsoever benefits that could have been derived there from or both given the above, this study shall examine the effect of Monetary Policy on indigenous firms operating in Nigeria, between 1983 and 1992. Monetary Policy refers to the management of the expansion and contraction of the volume of money in circulation for the specific purpose of achieving certain declared economic objectives (Uzoaga, 1981), which include achievement of a high level of gross domestic product, relative stable prices and relative full employment of resources (Odozi, 1993; Ojo, 1993; Umoh, 1993; Onoh, 1982 and Uzoaga, 1981) reasonable balance in the Balance of payment and stable internal and external, value for the naira (Umoh, 1993: 174). On the other hand, Indigenous Firms as used in this context refers to small-scale industries wholly-owned by Nigerians and whose annual turnover never exceeded ₦0.5 million.

For conceptual clarity, this study assumes Monetarist Orientation, with  $MV=PT$  (wherein money supply;  $V$  = Velocity of circulation of money supplied;  $P$  = general price level and  $T$  = total transactions done). Hence, when money supply rises, the general price level, within the domestic economy also rises and the vice-versa. "The monetary base ( $H$ ) is composed of Net Foreign Assets of the CBN (NFACB), Net domestic claims of the CBN on government (NDCCCB); CBNs claims on Commercial Banks (CCB); and Other assets (net) of the CBN (OACE) (Ojo in CBN Economic & Financial Review, Vol. 17, No. 3, 1993), Broad money is composed symbolically by  $\Delta MC = PC + GC + \Delta NFA + \Delta OA$  (where  $M_2$  = broad money;  $P_c$  = private sector Credit; Government Sector Credit; Foreign Assets;  $OA$  = other Assists;  $\Delta$  = change in). (CBN Economic & Financial Review, Vol. 30 No. 3, 1993).

#### *1.1. Policy Objectives of Monetary Policy Vis-A-Viz Indigenous Firms in Nigeria*

CBN Annual Report & Statement of Accounts (1983) indicated that the major objective of monetary policy in 1983 was to reduce aggregate demand in the economy, with a view to dampen the pressures on the Balance of Payment; increase the flow of credit to the priority sectors so as to expand the production of home-made goods and services, and thereby secure a further reduction in the rate of domestic price inflation. Further on this, the CBN, Annual Report & Statement of Accounts (1983) reported that for both Commercial and Merchant Banks, the permissible rates of credit expansion for big and small banks earlier fixed at 30 and 40% since 1978/79 were reduced to 25 and 35% respectively. Important to our work, banks were requested to give a minimum proportion of 80% of their total loans and advances to indigenous borrowers, out of which 16% should be to small-scale enterprises.

The above policy was contractionary to the economy, particularly with the reduction in credit expansion from 30 and 40% for small and big banks to 25 and 35% respectively. Superficially, one could expect reduction in borrowing from banks, but Nigerians were relatively not interest-sensitive. The CBN, Annual Report & Statement of Accounts (1983) revealed that due to inadequate demand for credit owing to economic recession and dull economic prospect, the banks deviated from the prescribed aggregate credit to the Private Sector (PC). They gave far below the prescribed minimum target. Correspondingly, this had adverse implications on productivity, particularly as investors speculated pessimistically about the economic prospects of borrowed funds. Though there is no statistics on small-scale indigenous enterprises, their condition might not deviate much from the above facts. Pathetically, as recorded by CBN, Annual Report & Statement of Accounts (1983), money supply rose significantly by 12.3%; the Gross Domestic Product declined; industrial production declined by 11.8%; manufacturing output slumped 20.7% while Agricultural production declined by 9.5%. Also, the Balance of Payment situation remained critical; inflationary pressures as worsened, unemployment became very serious and the policy, targets defeated.

Against the foregoing background, policy decisions of 1984 succinctly put by CBN, Annual Report & Statement of Accounts (1984) was directed to clear the backlog of accumulated trade debts and achieve substantial improvement in the Balance of Payments position; stimulate domestic production, reduce the rate of price inflation in the economy and mobilize increased domestic as well as external financial resources. In pursuance of the above objectives, the aggregate loans and advances of both commercial and Merchant Banks was reduced from 25% in 1983 to 12.5% in 1984, excluding loans for the purchase of shares by Nigerians under the Indigenization Scheme among others; raised minimum percentage of total loans and advances of banks to indigenous borrowers from 80% in 1983 to 90% in 1984, out of which a 16 percentage point shall be given to small scale indigenous enterprises (CBN, Annual Report & Statement of Accounts, 1984).

The policy, though contractionary in nature, reducing credit expansion from 25% to 12.5%, appreciated the need to further extend credit facilities to indigenous borrowers.

The CBN, Annual Report & Statement of Accounts (1984) pointed that the banks rather allocated 92.1% of their credit facilities to indigenous borrowers, but only 6.7% to indigenous small-scale enterprises as against the prescribed minimum of 16.0%. This discriminatory practice by the banks against the small-scale indigenous enterprises, through the loss of 9.3 percentage points was quite discouraging, except if there existed sufficient doubt on efficient application of the funds to meet desired objectives. However according to CBN, Annual Report & Statement of Accounts (1984) there was weak demand for credit, even among indigenous small-scale enterprises because of resistant economic recession, hence the deceleration in growth rate of total bank credit from 28.6% in 1983 to 10.5% in 1984 (as against the permissible limit of 12.5% in 1984) made money supply to be moderated to 8.2%. Invariably the indigenous small-scale enterprises were not really discriminated against, but were restrained from fully utilizing their credit by the ravaging economic recession. In effect, the policy objectives were not realized.

The 1985 broad objectives as streamlined in the CBN, Annual Report & Statement of Accounts (1985) was geared towards stimulating increased agricultural production; increased industrial production in order to reduce the persisting high level dependence on the external sector; reduce the rate of price inflation to a tolerable level; achieve a healthy balance of payment position and mobilize increased domestic and external financial resources to ensure increased capital formation. In order to affect this, policy measures taken included: the reduction of Commercial and Merchant Banks loans and advances from 12.5% in 1984 to 7.5% in 1985, excluding loans granted for the purchase of shares under the indigenization scheme among others; request by banks to lend not less than 16% of their total loans and advances to small-scale enterprises.

Empirically, behind the veil of contractionaries of the policy, it gave teeth to small-scale indigenous enterprises, which in spite of the reduction of credit expansion from 12.5% to 7.5% were still allocated 16% of the total loans and advances of banks. Unfortunately, CBN, Annual Report & Statement of Accounts (1985) indicated there was lull in business and economic recession, which reduced credit expansion of Commercial Banks to 5.5% as against the permissible growth rate of 7.5%. We greatly suspect the indigenous small-scale enterprises were also affected by the same economic hullabaloo. Generally, money supply observed in CBN, Annual Report & Statement of Accounts (1985) rose by 8.7% as against the monetary policy target of 6.2%. This was due to above target increases in foreign assets and other assets of the banking industry. In effect, this had adverse effects on inflationary pressures, industrial production, Balance of Payments position among others.

In the 1986 fiscal year, the Monetary and Credit policies were according to CBN, Annual Reports & Statement of Accounts (1986) designed to achieve an accelerated growth rate in national output; reduction in the high rate of unemployment; moderation of the inflationary pressures in the economy; stimulation of increased financial savings and capital formation and expansion and diversification of the export base in order to restore a healthy Balance of Payments position. In pursuance of these objectives, certain measures were taken, which according to CBN, Annual Reports & Statement of Accounts (1986) included the raising of Commercial Banks loans and advances from 7.0% in 1985 to 10.0% in 1986; and directive for banks to lend not less than 16% of their total loans and advances to small-scale indigenous enterprises.

This policy adopted a Structural Adjustment Programme (S.A.P) and this perhaps explains the strange element in the Credit Policy. The shift from reduction to increase in credit expansion for banks. This reduction is expedient with regard to capital formation and increasing national output. No available financial record revealed the impact of this policy on the economy.

The 1987 Monetary and credit Policy measures were designed to facilitate the attainment of the goals of the Structural Adjustment Programme. Specifically, the policy objectives were to moderate inflationary pressures likely to

arise from the large depreciation in the naira exchange rate on the Second-Tier Foreign Exchange Market (SFEM); stimulate domestic financial savings; encourage foreign capital inflow and increase export earnings from non-oil sources; stimulate local production of goods and services and ensure improvement in the Balance of Payment (CBN, Annual Report & Statement of Accounts, 1987). In order to achieve these objectives, the monetary and credit guidelines were largely restrictive and included according to CBN, Annual Report & Statement of Accounts (1987) the following credit policy targets: 11.8% growth in the money supply; 4.4% growth in aggregate bank credit; 1.5% expansion in credit to government and 8.4% growth in credit to the private sector. In addition to this, the economy formerly categorized into four sectors was reduced to two, - viz: "high priority sectors"- (agriculture and manufacturing enterprises) and "others"; A ceiling of 15% interest rate was placed on bank lending; a minimum interest rate of 11% was placed on savings deposits and a minimum rate of 12% was fixed for time deposits. Later, on August 1, 1987, all the controls on interest rates were removed in line with emphasis on deregulation of the economy.

The deregulation noted above was congruent to Onoh (1982) and Umoh (1993's) observation that Nigerians are insensitive to changes in interest rate. They borrow, with little if any regard to the implications of such borrowed fund. Most importantly, the banks allocated 18.7% of total credit to indigenous borrowers to small-scale enterprises as against the prescribed 16.0%. Naturally, this was supposed to enable the small-scale enterprises make some giant strides in productivity. But did they really increase national output? CBN, Annual Report & Statement of Accounts (1987) indicated that monetary expansion exceeded its target of 11.8% by 5.3 percentage points, due to 14.3% rise in aggregate bank credit (net) to the domestic economy as well as the 34.8% increase in foreign assets. In sum, inflation was exacerbated; Balance of Payment position deteriorated further among other things and hence confounded the policy targets of the year.

Against the background of 1987 economic conditions, the Monetary Policy of 1988 as recorded by CBN, Annual Report & Statement of Accounts (1988) shows that the policy aimed specifically at: stimulating growth in national output; create more employment; enhance financial savings and efficient resource allocation; moderate the rate of price inflation and improve the Balance of Payment position. In pursuance of these objectives, targets made included 15% growth in money supply; 8.1% growth in aggregate domestic credit; 2.5% expansion in credit to government; 13.3% growth in credit to the private sector; 12.5% credit expansion for Commercial and Merchant Banks; reduction of the rediscount rate from 15 to 12.75% reduction of minimum liquidity ratio from 30.0 to 27.5% for Commercial Banks and fixing a 20% ratio for Merchant banks; retention of the provision that a 16% of Commercial Banks total loans and advances be allocated to small-scale enterprises.

The immediately above policy was relatively relaxed and comparatively expansionary. On the surface, one expected that firms could easily get loans and advances for their businesses, as credit facility was increased by the Central Bank. All of these ultimately tend towards realizing the policy objectives enumerated above, hence with reduction in lending rate, the cost of borrowing capital was reduced and firms could borrow as much as they required, thereby increasing output, generating employment and meeting up with the increased aggregate demand. Correspondingly, Loan disbursements to small-scale enterprises exceeded the 1988 minimum target; it was 21.0% (₦4.2 billion) of their total credit to indigenous borrowers as against prescribed 16.0% (CBN, Annual Report & Statement of Accounts, 1988). This increased the liquidity of small-scale indigenous firms, but was the fund efficiently utilized? Did it enable the entrepreneurs realize the objectives of increased productivity? The CBN, Annual Report & Statement of Accounts (1988) reported that money supply rose sharply, reflecting the expansionary impact of the ₦10,810.8 million or 26.1% increase in aggregate bank credit to the domestic economy, largely to Government Sector as well as ₦987.4 million or 14.6% net accretion to foreign assets of the banking system. Inferentially, inflation persisted, Balance of Payment worsened and economic growth arrested, thereby complicating small-scale enterprises modalities for realizing their objectives.

The basic economic policy objectives for 1989 were moderation of inflation; reduction of pressures on the external sector with a view to achieving a viable Balance of Payments positions; stabilizing the naira exchange rate and building up adequate external reserves; stimulation of private sector production capacity and output and generation of employment (CBN, Annual report & Statement of Accounts, 1989). To achieve these, the permissible rate of credit expansion was put at 10.0%; there was a retention of the provision that a minimum of 16% of Commercial Banks loans and advances be allocated to small-scale indigenous enterprises among others.

The above policy was moderately contractionary, as observed by CBN, Annual Report & Statement of Accounts (1989). It was essentially unlike the 1988 policy which was a bit expansionary. For instance, permissible rate of credit expansion was reduced from 12.5% in 1988 to 10.0% in 1989. The impression made in this regard is that cost of acquiring capital for business from the banks would be costly, and hence discourage investment and or at best compel investors to efficiently manage their available resources (funds). However, this was not exactly so. The CBN, Annual Report & Statement of Accounts (1989) reported that bank's credit to the private sector maintained an upward trend during the year and that both Commercial and Merchant Banks exceeded the set credit ceiling of 10.10% and gave up to 14.9% Also, the proportion of loans and advances given to small-scale enterprises was (₦1.3 million) or 21.2%, which exceeded the prescribed minimum target of 16.0% by a 5.2 percentage point.

Empirically, the above findings of the Central Bank suggest a moderation of cost of capital, such that investors could easily borrow funds from the banks for their business, and with all things being equal, increase national output, increase employment and stem the high inflationary pressures. General, it was no wonder, the CBN, Annual report & Statement of Accounts (1989) observed that the policy indicated positive results. For instance, the pressures on the external sector eased considerably as shown in the turn-around in the Balance of Payment, though the high rate of inflation remained a major source of concern.

Paradoxically, the CBN Annual Report & Statement of Accounts (1990) highlighted that the major economic problems at the end of 1989 which formed the background to the design of economic policies in 1990 were high domestic inflation, rising interest rates, domestic supply shortages, limited employment opportunities, inadequate foreign resources and a large external debt burden. On the basis of these, the policy was designed to: moderate the inflation rate; reduce the pressures on the external sector and stabilize the exchange rate; induce increased financial savings, investment and employment and to stimulate private sectors productive capacity. To achieve the above policy objectives, policy targets made included: 13.0% growth in money supply; 13.5% growth in aggregate bank credit; 10.9% growth in credit to government and 15.8% growth in credit to the private sector. Others include re-introduction of the issuance of non-transferable and non-negotiable stabilization securities to banks whose reserves were far in excess of the stipulated reserve requirement and most importantly, the increase of the shares of aggregate bank's loans to small-scale indigenous enterprises, excluding activities in general commerce, from 16.0 to 20.0%.

Logically, the 1990 policy was an incentive to investment. Credit facilities were expanded and specifically with regard to the small-scale indigenous enterprises, they had increased access to banks loanable funds (from 16.0% in 1989 to 20.0% in 1990). As has recently been observed, the CBN, Annual report & Statement of Accounts (1990) recorded that the banks exceeded the prescribed minimum target of 20%, as the proportion of their loans and advances to the sector was 22.9%. Ordinarily, one could expect "great leaps forward" in national output; increased employment opportunities and an attempt to reduce aggregate domestic demand, but for the fact which CBN, Annual Report & Statement of Accounts (1990:12) reported that the money stock grew by 44.9% as against the stipulated target of 13.0% in 1990. This was said to be due to the unsustainable high rate of monetization of foreign exchange earnings of the public sector and the sharp rise in credit to the domestic economy.

Against the foregoing problem of 1990, the Monetary Policy of 1991 specifically aimed at: moderate the inflation rate; reduce pressures on the external sector and stabilize the naira exchange rate; induce increased financial savings; investment and employment (CBN, Annual Report & Statement of Accounts, 1991). In attainment of the above objectives, the report of CBN, Annual Report & Statement of Accounts (1991) had it that the stance was to be moderately restrictive. The permissible rate of increase in bank credit to the private sector was fixed at 13.2%; the Commercial Bank's total credit outstanding allocated to small-scale enterprises, excluding activities in general commerce was retained at 20%.

As revealed by the above records on the 1991 policy, although the policy reduced aggregate credit to the private sector from 15.8% in 1990 to 13.2% in 1991 (which with all things being equal, suggests reduction in loanable funds of the banks as well as increase in the cost of acquiring funds from the banks), small-scale indigenous enterprises were not so much disadvantaged. They were entitled to 20% of total loans and advances to indigenous borrowers. In all intents and purpose, this gave the small-scale indigenous enterprises privilege to source required volume of funds from the banks and, in effect, the impetus to increase productivity, enhance national output among other things. But was this realized? The CBN, Annual Report & Statement of Accounts (1991) recorded that the banking system credit to the private sector rose by 23.7% as against the prescribed maximum of 13.27% and the Commercial Bank's loans to small-scale industries exceeded the stipulated minimum target of 20.0% by 3.8 percentage points, which taken together has potentials for increased productivity (when efficiently allocated to specific uses), increase investment and employment, moderate the inflation rate (through reduction in aggregate domestic demand) among others. These were frustrated by the growth rate of the money supply which exceeded its stipulated target. It grew by 32.6% as against the 14.6% target for the year, due to sharp increase in banking system's credit to the economy as well as the monetization of the foreign exchange receipt of the public sector. According to the Monetarists, this sudden increase in money supply affects the domestic price, leading to instability in price. For this, one doubts the fruitfulness of the efforts of small-scale enterprises.

The 1992 economic policy package was adopted against the background of high rate of domestic inflation, persistent pressures on the Balance of Payments, low output growth and high level of unemployment. Specifically, the 1992 policy measures were expected to increase the growth in real GDP from 4.3 to 4.5%, reduce the inflation rate from 13.0 to 5.0% and achieve an accretion to external reserves of \$1.1 billion. In order to realize this, the ceiling on the growth of aggregate bank credit to the economy was 13.2%, compared with 10.6% in 1991. Bank credit growth to government and the private sector was fixed at 7.7% and 17.7%, respectively, compared with 0.0 and 16.0% in 1991; the requirement that Commercial and Merchant Banks allocate a minimum of 20% of their total credit outstanding to small-scale enterprises was retained (CBN, Annual Report & Statement of Accounts, 1992).

As shown above, the 1992 policy was moderately expansionary. It permitted creation and expansion of credit, which with all things being equal made for increased liquidity of the economy; encouraged investment and have in the short-run implications on complicating the inflationary pressures but on reducing aggregate demand and hence inflation in the long-run. However, CBN, Annual Report & Statement of Accounts (1992) revealed that the major factor that dictated the outcome of macroeconomic policy during 1992 was the financing by the Central Bank of the large fiscal deficit of the Federal Government, which pathetically results in rapid monetary expansion, accelerating inflation, exchange rate depreciated and the real sector performed inadequately.

## 2. Conclusion

In all, the macroeconomic problems: high inflationary pressures; retarded growth in national output; low capacity utilization; unemployment and disequilibrium in the Balance of Payment persisted in Nigeria, not because policy decisions were not designed to address the problems but that the policy targets were

Monetary and Credit Targets particularly money supply often exceeded its prescribed maximum targets (sometimes through above target expansion of credit to the government sector and sometimes through accretion of Net

Foreign Assets and other Assets) and hence exacerbated inflation. Eventually, this confounded the productivity of small-scale indigenous enterprises and made realization of policy objectives a day-dream. In recommendation, given that money supply affected general price level, which effected the real sector of productivity and employment, efforts should have been made to reduce expansion of credit of the government sector as well as accretion of foreign assets (net) and other assets, to which money supply was responsive. Then, the policy objectives of stable price, economic growth, rise in employment and favourable Balance of Payment could have been attained.

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