

**PANEL ON THE
REORGANISATION AND
REFORM OF CENTRAL BANK
OF NIGERIA**

**EXECUTIVE SUMMARY
OF
THE MAIN REPORT**

1994

EXECUTIVE SUMMARY

0.01 Developments in the Nigerian economy since independence are characterised by neglect of agriculture, the emergence and decline of manufacturing, and the increased dominance of the petroleum sector as a source of public revenue and foreign exchange. Yet, the petroleum sector exists as an enclave and is not structurally linked, in any significant manner to the real sectors of the economy. The promise of the emergence of manufacturing as a major sector has also not been realised. Since the early 80s, external debt has ballooned, external reserves shrunk, and inflation has soared.

0.02 Initially, the responses to these difficulties took the form of demand management through stabilisation and austerity measures. However, these could not work over a long period of time, as the cost involved became unbearable. From 1986, the government launched a major new initiative in the form of a structural adjustment programme (SAP), aimed at liberalising the economy, reducing external and internal deficits, restructuring and diversifying the economy and engendering growth.

0.03 During the first two years of the implementation of SAP, there were improvements in virtually all economic indices. However, between 1989 and 1993, the burgeoning government expenditure in time Face of dwindling revenues, led to a growth in government deficits running into an average of 9.74% of GDP. Rapid inflation, a high rate of unemployment, a heavy debt burden, high Interest rates and a rapid depreciating Naira value emerged as serious problems. In this environment, growth in any meaningful sense was well nigh impossible.

0.04 As the economy was experiencing trauma, the financial system came under stress, with a significant number of institutions in distress. Much of the blame for this development has been erroneously laid at the doors of the Central Bank, simply because it is the main supervisory and regulatory institution in the financial system. Even if the accusations are not totally justified, nevertheless, the Bank cannot be absolved from blame because it does have responsibility for maintaining a stable financial system without which these problems cannot be satisfactorily resolved.

Evolution of the Central Bank of Nigeria

0.05 The Central Bank of Nigeria Act 1958, its subsidiary legislations, Central Bank of Nigeria Decree 1969, and the Banking Decree 1969 established the framework governing the operations of the Central Bank. The laws made the Bank accountable to the Government through the Ministry of Finance. The Central Bank of Nigeria Decree No. 24 and the Banks and Other Financial Institutions Decree No. 25, of 1991, on the other hand, detached it from the supervisory ambit of the Federal Ministry of Finance and put it squarely in the arms of the President. Even this arrangement has proved unsatisfactory because the law has placed the Governor, almost unwittingly, in the cadre of one of the President's officers.

The Legal Framework

0.06 The Panel reviewed the laws governing the operation of the Central Bank with a view to taking the steps to strengthen the Bank and insulate it from direct political influences and pressures. At the end of the review, we came to the conclusion that the Bank should be independent of the Presidency with respect to the formulation and implementation of monetary policy.

0.07 We believe that a complete autonomy for any central bank is purely fictional, as there is no way it can be totally divorced from government. However, it should be sufficient to ensure that the monetary policies the central bank formulates flow from the overall fiscal and budgetary policies of the government. A central bank should develop the competence and expertise that would allow it the leverage it needs to formulate and implement monetary policy without any reference to government. All the provisions of the law that limit the ability of the Bank to act independently should be expunged. A clear example of one of such laws is the requirement that the Bank should seek the President's approval before exercising the power to revoke banking licences, to determine the minimum paid-up capital of licenced banks, to remove erring and fraudulent bank officers, takeover the control and management of failing banks and to make and amend banking regulations, etc.

0.08 To further ensure the independence of the Bank, the Panel recommends that the Governor be appointed by the President and the appointment confirmed by the Senate. The Governor should also report twice a year to the

Legislature. The Annual Report and Audited Accounts of the Bank should also be laid before that body.

0.09 Stiffer penalties are also proposed to deter malpractices by promoters, directors and officers of banks. They should now be held responsible for loans that have become bad, if fraud or negligence on their part is established. The Panel also sought to strengthen the judicial arrangements by recommending the creation of a special division of the high Court for dealing with cases involving fraud or bad debts. The Panel concluded that contrary to the general impression, the Bankruptcy Law cannot be used effectively to remove the difficulties faced by banks in recovering their non-performing loans and advances. Banks have to use the remedies provided in the other existing laws, using the Bankruptcy law only as a last resort.

The Regulatory Framework for the Financial System

0.10 There are over ten institutions each of which regulates some aspect of the financial system in Nigeria, namely, the Presidency, the Central Bank of Nigeria, the Nigeria Deposit Insurance Corporation (NDIC), the Federal Ministries of Agriculture, Commerce, and Industries, the Securities and Exchange Commission, the Federal Mortgage Bank of Nigeria, the National Board for Community Banks and the National Insurance Supervisory Board. There is a reasonable degree of coordination in the regulatory arrangement between these agencies and most of the relevant financial institutions they regulate. However, the framework for other organisations like time discount houses, finance companies, development finance institutions (DFIs), the Federal Mortgage Bank of Nigeria and the Peoples Bank of Nigeria, is either ambiguous, unclear, or grossly inadequate. More fundamentally, the failure of the supervisory arrangement has become manifest as it has failed to detect and rectify distress in a significant number of financial institutions. As the number of these institutions has increased, the inefficiency of the supervisory agencies has come to the fore.

0.11 To address the problem, there is the need to coordinate all regulatory agencies with the CBN at the apex. A proposed framework involves the establishment of the Financial Services Coordinating Committee (FSCC), and the strengthening of the powers of the Central Bank and NDIC to take decisive steps to deal with distressed financial institutions. The members of

FSCC should be the Chief Executives of all the apex regulatory institutions, with the Governor of the Central Bank as Chairman. The aim of the Committee should be to coordinate the regulatory functions of the members and encourage exchange of information and standardisation, as much as possible, the format of reporting. With regards to the NDIC we have proposed measures to strengthen the Board and the Management of the Corporation and empower it to impose strict conditions for admission and termination of insured status for licenced financial institutions. We have also proposed an additional provision in the law to make the loss of insured status by a bank to be sufficient ground for the revocation of its banking licences.

Domestic Operations of the Bank

0.12 For the efficient conduct of its domestic operations, it is crucial that the Central Bank expands its human resources and its computing capabilities for effective bank examination to be conducted at least once a year. It is also essential for the Bank to build up the capability to provide an early warning signal against distress by monitoring full compliance with prudential regulations. The Bank must also regularly examine and supervise other financial institutions.

0.13 We have received a good number of allegations of corruption among the Bank's staff, where it is often alleged that bank examiners admit inaccurate and falsified returns from banks. No one has, however, come forward to corroborate these allegations, although it is evident from what we have seen, that shortage of qualified and experienced staff, hitherto low level of emoluments amid pressures on existing personnel may account for some of the observed lapses in bank examination and supervision activities. We have also noted that delays are reported in cheque clearing processes in the banking system e, supposedly, to ineffective communication between the headquarters, branches and currency centres of the Bank. The result is that banks are thereby having difficulty in ascertaining their net positions at a glance.

0.14 The Panel has noted that several steps are already being taken to address the clearing problems. The Magnetic Ink Character Recognition (MICR) Programme is now being pursued along with the Nigeria Inter—bank Settlement System Plc (NIBSS). The automation of the present Central Bank

cheque clearing system should also be rapidly implemented and the numbers of skilled and qualified staff should be increased. Although a lot of the problems are attributed to the inadequacies in the communication system, we believe that even before the introduction of an enhanced communication system, it is possible to reduce the delay at each stage of local clearing, intra-State clearing and inter-State clearing. We believe that the strengthening of the Zonal Office of the Bank and the grant of adequate powers to the Zonal Controllers to introduce inter-Zonal clearing and an effective distribution of currency within the Zones will be a positive step in the right direction.

Growth and Management of Domestic Debt

0.15 Domestic debt has risen from 10.7% of GDP in 1960-79 to an average of 32.5% since 1980 and 32.8% in 1993. In absolute terms, the domestic debt has risen from N22 billion in 1984 to N262 billion in 1993. The budget deficit stood at N101 billion in 1993, nearly 130% of retained Federal Government revenue, as against N2.6 billion in 1984. The Ways and Means Advances is the main source of financing the deficit. In spite of the stipulation in CBN Decree No. 24 that the Bank must not advance more than 12.5% of recurrent budget revenue of the FGN, it has always exceeded 50% during the last seven years.

0.16 The Panel has been most concerned by the impact of the budget deficits on the Nigerian macro—economy. It is not the size of the debt alone that has been worrying, but the misallocation of resources resulting therefrom. Public expenditure has moved away from production to consumption due to availability of easy and cheap money to government. These have combined to generate rapid inflation and cause a depreciation in the Naira exchange rate.

0.17 A corollary of this problem is that there is too incentive for any serious revenue drive by government Ministries and agencies. The Panel, is therefore, persuaded of the crucial importance of implementing a system of rewards and sanctions to facilitate revenue drive by the relevant arms of government. The growth of Ways and Means Advances must be checked and the Central Bank Governor must be enabled to refuse to act on requests to issue WAMA beyond the stipulated ceilings. Government needs to demonstrate exemplary discipline by restraining extra-budgetary expenditures, the temptation to operate a

parallel budget, which distorts efficient resource allocation and subverts transparency in the management of public funds.

0.18 The Panel believes that the Bank should, under no circumstances, grant advances to the government in excess of time stipulated 12.5% of estimated federal government recurrent revenue and any breach of this law by the Bank should constitute sufficient ground for removal of the Governor. Deficits beyond this figure should be funded from the capital market, using conventional government instruments.

0.19 The Panel has observed the preponderance of short term securities until 1993 when nearly half of the stock of Treasury Hills was transformed into Treasury Bonds. While we commend the effort and the move being made towards the restructuring, we note that the bulk of both the short and the medium term debt instruments was still held by the Central Bank. In the event, we have to suggest that greater efforts should be made to transform the maturity and ownership structure of these debt instruments. Payment of domestic debt, hitherto treated with levity by successive governments, must also be adequately provided for in annual budgets.

External Sector Policies

0.20 The Bank is responsible for formulating and realising the external sector policy objectives of the country. In the management of external reserves, the Bank has been guided by the need. to provide liquidity for settlement of transactions with the outside world, the maintenance of international credit worthiness and the build-up of reserves as buffer against external shocks. But persistent balance of payments deficits have forced the Bank to liquidate its investments in some high yielding foreign securities. The Panel is of the view that the present strategy, whereby the larger proportion of the country's reserves arc held in secure, liquid, hut low-yielding assets should be maintained. The law should, however, be amended to re-introduce the requirement that the Bank should, at all times, maintain a minimum reserve holding equal to 25% of its demand liabilities. Government should also curtail its excessive expenditures in order to conserve the foreign exchange earnings.

Foreign Exchange Management

0.21 In the 1994 budget, the government introduced a new regime of policies after seven years of deregulation. Under the new policy, the Naira exchange rate was pegged at N21 .9960 to one US dollar. The Panel believes that unless supporting measures are put in place and strictly implemented, and the required resources are available to sustain the policy, the system is bound to fail. Going by' the past experience, even the new scheme of prioritisation is not likely to achieve much because prioritisation can be highly subjective. In offering assistance to the organised private sector, Government should define clearly what groups it proposes to support and the contribution expected from such groups hi the nation's industrial growth.

0.22 On exchange rate determination, we believe that a sufficient basis now exists for the Bank to use the Multiple Exchange Rate System as a short-term pragmatic e*change rate policy. At the same time, allowance should be made for the official rate to be applied to direct Government purchases of goods and services strictly adjudged to be essential for economic development. The second window at market related prices should apply to all other Government and private sector transactions. The Bank should be free to intervene to keep the exchange rate within a band: The success of this arrangement would, however, depend on the efficient and correct functioning of the first window. It should be mentioned that not only has the exchange rate been pegged, but that the responsibility for the allocation of what is available has been vested in an inter-Ministerial Committee. The installation of such a committee operating in the Central Bank to perform the Bank's statutory function, even with the Governor of the Bank as the Chairman, suggests a lack of confidence in the Bank. It puts the integrity of the Bank at risk and suggests that Government has no respect for professionalism in the management of one of the most sensitive parameters of monetary policy.

0.23 Our view is that such a Committee is totally unnecessary and that foreign exchange allocation and management must revert to those who arc professionally capable to handle it, that is, the Central Bank. We recommend that the inter-Ministerial Committee and those others that have been injected into the system from outside the Bank be relieved of that responsibility.

External Debt Management

0.24 The size of Nigeria's external debt has grown from US\$17.3 billion in 1984 to US\$28.7 billion in 1993. Unless the debt service problem now running at over 4% of the GDP is effectively addressed, it would be extremely difficult to put the economy back on the path of sustained recovery and growth. The character of this formidable problem has significantly shifted from predominantly private debt to predominantly official debt. As it is a precondition, for negotiation with the Paris Club that a country seeking concessionary terms on its debts must first conclude negotiations on Medium Term Economic Programme (MTEP) and adopt the International Monetary Fund's (IMF) Enhanced Structural Adjustment Support Facility (ESASF), it is important for Nigeria to cooperate actively with these institutions so that a pragmatic approach to solving the debt problem could be worked out. With respect to the foreign consultants, S.C. Warburg, assisting the Bank and the Federal Ministry of Finance on the debt negotiation, the Panel believes that much will be gained by attaching a local firm of consultants to the foreign consultants for the sake of transfer of techniques.

Formulation and Implementation of Monetary Policy

0.25 Consistent with the macroeconomic objectives, monetary policy has over the years aimed at moderating the inflation rate, reducing pressure on the external sector, stabilizing the Naira exchange rate, the balance of payments and inducing increased financial savings, investment and employment. Until recently, the Bank had relied on direct control instruments for the execution of monetary policy but these have proved ineffective, so the Bank is now moving more and more towards the use of indirect control instruments. The impact of the large fiscal deficit financed by the Bank through Ways and Means Advances has neutralised the effect of these policy instruments and induced frequent changes of policy measures within the year. For instance, in 1989 alone, there were eleven amendments to the Monetary Policy Circular much to the frustration of banks and other players in the economy.

0.26 The replacement of direct instruments of monetary policy with indirect market-based instruments, particularly the open market operation (OMO), which makes for greater stability, should be pursued gradually and extended as the financial environment develops. The Panel believes that a full-scale

deregulation of interest rates should be preceded by adequate preparation of the financial infrastructure and more sophisticated and effective banking supervision. The objectives of monetary policy are commendable, but every effort should be made to ensure fiscal discipline in the economy.

Coordination and Harmonisation of Fiscal and Monetary Policies

0.27 Over the past seven years, the discrepancy between Government fiscal and monetary policies has reached an unacceptable level due mainly to lack of an institutional structure which will allow for effective consultation, cooperation and coordination between the Central Bank and the Federal Ministry of Finance. At present, although the Central Bank and the Federal Ministry of Finance do participate in pre-budget consultations, the fiscal and monetary policies are in reality drawn independently.

0.28 The solution in our view, lies in the establishment of a high level Committee, namely the Committee on Fiscal and Monetary Policies comprising of both the Central Bank Governor, the Minister of Finance and the Minister of National Planning, and Petroleum Resources, and the Economic Adviser to the President as members, with the Vice President as Chairman. This should ensure a proper coordination of fiscal and monetary policies not only during the formulation of the policies, but at various stages of implementation.

Administrative and Management Structure of the CBN

0.29 Over the years, the functions of the Bank have grown in complexity, with significant changes in the composition of its management. As the number of Deputy Governors has increased from one (1) to five (5), the Board of the Bank has increasingly become an Executive Board. The number of departments has equally grown from two (2) to twenty-five (25), thereby posing serious problems of harmonisation, coordination, and hence efficiency. Several functions that are currently being performed by separate departments need not be so. The Bank structure needs to be trimmed and be made more manageable. The quality of Bank staff at middle management level was also found to be low because many were recruited in their prime into very junior positions and have risen in rank without any outside experience. Although some of the staff have spent several years in the bank, they have not

acquired additional or relevant qualifications. A good number of them acquired their qualifications late. They, therefore, have a pathological fear of change and are reluctant to embrace new techniques and technologies. As the Bank's succession plan depends on this level of managers, a way should be found to ease out such staff.

0.30 All staff who have served up to 10 years and above, but who have not acquired the requisite qualification for senior position should be eased out. Those who have served over 30 years without appropriate qualification should be asked to go on attractive terms. Those who have served between 20 and 30 years and have reached the end of their scale without promotion, but are considered to be exceptionally good, should be moved to the next higher scale to be made personal to them; thereafter, they should stay until retirement. Those who have the required qualification, but have shown declining productivity should be eased out.

0.31 We propose that the Board too be strengthened with the appointment of one (1) non-Executive member who should be the Director-General, Finance in the Federal Ministry of Finance. We also propose that the number of departments be rationalised and be reduced to seventeen (17) and that the Agricultural Finance Department be transferred to the Nigerian Agricultural Insurance Corporation (NAIC). Similarly, the retail banking functions of the Bank should be excised.

0.32 On staff welfare, the existing in-house clinics should be retained, while stand-by clinics should be utilised in all other locations. The staff catering services should be monetised in all locations, with the possible exception of Abuja.

Management Information System

0.33 Since the early 80s, the Bank has experimented with six (6) systems which turned out to be obsolete. The Bank's efforts failed due to the lack of a strategic framework within which these disparate projects were being executed. The Bank, therefore, commissioned a Strategic Study (the 155) in 1991, whose recommendations were adopted by Management in 1992. The project comprised of four components, namely:

- An area-wide Satellite network linking all the Bank's 22 locations;
- PABX;
- Computer Infrastructure; and
- MICR

0.34 Two options for the implementation of the project were recommended to the Bank:

Option I - Complete ISS Project including the full satellite network, with terrestrial backup to link the 22 branches at a cost of N1.5 billion. Quotations from tenders, however, brought it down to N 1.2 billion.

Option II - Reduced I SS Project with a terrestrial link, in place of the full satellite network (the satellite to link up only six branches) at a scaled down cost of N611 million.

0.35 We recommend the adoption of Option I of the implementation Plan of the ISS with full Satellite network. The Consultants should be requested to review and evaluate all candidate software systems. In doing so, they should not be limited by the fact that there is already a software system in use (BANKOS) and installed in six (6) locations, nor should they be limited by those systems earlier suggested. Similarly, they should review and evaluate the hardware architecture needed for the project not minding that three (3) such hardware architectural systems had been previously denominated. On its part, the Bank should ensure that it obtains the best terms and conditions for the supply of both hardware and software. In respect of BANKOS, the system should be restricted to the six (6) locations where it is currently in use until all other software packages have been re-evaluated in the light of requirements of the ISS Project. If the decision is to adopt an alternative software, then BANKOS should be phased out over a short period. If, however, the BANKOS system is to be adopted, then it should be extended to cover all the other branches.

0.36 Prior to the ISS Study, the Bank had selected the BANKOS software system, for the core banking applications. This software has been found to be poorly documented, unstable and had to be enhanced and maintained at

great cost. The subsisting agreements under which the Bank purchased its software, leased its hardware and pays for the accompanying services need to be renegotiated.

0.37 The Bank should also make strenuous efforts to recruit sufficient number of skilled professionals to enhance the managerial capacity of the M.I.S. Department, to enable it to cope with the requirements of the ISS Project.

Dedication and Other Special Accounts

0.38 In 1988, the President authorised the dedication of crude oil of 65,000 barrels per day for the finance of special priority projects including Ajaokuta Iron & Steel, Itakpe Iron Mining, and Shiroro Hydro-electric projects. The account was also to be used for external debt buy-back and the build-up of reserves. The quantity was subsequently increased to 105,000 barrels per day and in early 1994, to 150,000 barrels per day. In addition, a stabilisation account to receive the windfall of oil proceeds of the Gulf War and a special account for Mining Rights and Signature Bonus were opened. Altogether, \$12.4 billion was received into these accounts from 1988 to June 1994, all of which have been spent leaving a balance of \$206 million as at the 30th June, 1994. The problem with these accounts is that even when the revenues were shown globally as in the case of the dedication account, the expenditures were not included in the Federal Budget.

0.39 Apart from the projects for which the accounts were established, their use was extended to a wide variety of projects many of which could not be classified as priority. The details of receipts and disbursements on these accounts were, however, carefully maintained and all payments were duly authorised by the President. If only the funds had been regarded as part of the external reserves and had been counted as such, the impact on the exchange rate in the year under review would have been so significant that the Naira would have been stronger in 1994, in relation to the dollar, than it was in 1985.

0.40 The Panel recommends that the dedication and special accounts be discontinued and any existing balances be taken into the external reserves of the Central Bank.

Conclusion

0.45 The reorganization and reform of an institution such as Central Bank has to be approached from different perspectives. We have had to look into the laws governing the establishment and development of the Bank, its relationship with Government and other financial institutions; the infrastructure of instruments with which it performs its statutory role as the monetary authority; the administrative and management structure and the application of information technology in the discharge of its functions and responsibilities. In this Report, we have tried to develop a Central Bank that would facilitate the effective management of the economy, provide non-inflationary support to Government and foster a healthy financial system: a Bank that would be insulated, as much as possible, from the direct influences and powers of office holders, and could inculcate in its functionaries the ethics of hardwork and transparency.

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