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Keynote Address

*Mallam Sanusi Lamido Sanusi**

Deputy Governors,
Departmental Directors,
Branch Controllers,
Eminent Resource Persons,
Distinguished Executives,
Ladies and Gentlemen.

1. It is my pleasure to be with you as the Special Guest of Honour at this year's annual Executive Seminar taking place again in Lagos after almost two decades since the inaugural edition. The theme for this year's Seminar "**Financial Sector Development, Economic Growth and the Nigerian Economy"** is indeed pertinent, particularly at this period when the advanced economies are refocusing strategies on banking sector stability so as to safeguard their seemingly fragile financial systems from the risks of financial contagion. In addition, this event is coming at the heels of the implementation of the 'Cash-less' policy aimed at achieving an environment where a higher and increasing proportion of transactions are carried out through other modes of payment other than cash, in line with the global trend. The 'Cash-less' policy, which had already commenced in the Lagos Area under a pilot scheme, was designed to, among others: smoothen financial intermediation; promote financial inclusion; minimize revenue leakages; eliminate incidence of robbery; free the financial system from the burden of high cost of currency management, arising from the preponderance usage of cash in the settlement of financial transactions.

2. As you are all aware, the financial sector consists of an array of institutions and processes, which include: specialised and non-specialised financial institutions; organised and unorganised financial markets; financial instruments and services, among others, all of which facilitate mobilisation, utilisation and transfer of funds. These institutions, as we know, are not always mutually exclusive; rather, they function as a set of complex and closely intertwined units, within and between the markets and the economy. It is therefore not out of place to assert

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that the financial system is the hub on which the growth of a nation's economic activities gravitates.

3. Ladies and Gentlemen, you all know that the role of the financial sector in economic growth and development has for a long-time occupied the minds of economists. From Adam Smith to Maynard Keynes and Paul Samuelson to Joseph Stiglitz, economists have continued to explore the various channels through which financial sector development contributes to economic growth. Generally, scholars have observed that long-term sustainable economic growth depends on the ability to raise the rates of accumulation of physical and human capital as well as the efficient use of the resulting productive assets. Therefore, it is imperative that the financial sector which forms the major catalyst to economic growth, be well-developed to accelerate the growth of savings, capital formation and investment.

4. Let me reiterate the fact that financial sector development involves the nurturing and expansion of the institutions, markets and all the processes that support financial intermediation. At the centre of this nurturing is the improvement of financial intermediation within the economy. First, this involves the mobilisation of domestic and foreign savings for investment by households and firms/corporate entities. Second, that the funds mobilised are allocated to the most productive use and third, the provision of liquidity to enable investors to operate efficiently. The main drivers of financial intermediation are the banks and non-bank financial institutions, which not only allocate pooled savings for investment, but also, monitor, absorb and allocate associated risks.

5. You will recall that the Nigerian financial sector has witnessed considerable improvement over the years, with the Central Bank of Nigeria and other regulatory authorities spearheading most of the reform initiatives in the face of the numerous challenges posed by internal and external economic conditions. The bank consolidation exercise of 2004-6 saw improved capitalization and expansion of banks' business capacity. The downside was that banks overstretched their limits without complementarily up-scaling their risk management and corporate governance capabilities. These led to erosion of capital and created liquidity challenges in the financial markets. In response, the CBN took drastic actions, including the removal of some banks' CEOs to avert crisis in the financial system.

6. In recognition of the primacy of the financial sector, the Bank introduced a new set of reforms to restore confidence and strengthen the banking sector to engender long-term sustainable growth of the economy. These reforms were anchored on four broad pillars, namely: enhancing the quality of banks; establishing financial stability; enabling a healthy financial sector evolution; and ensuring that the financial sector contributes to the real economy. Specifically, the Bank introduced a new banking model to replace the erstwhile universal banking framework that allowed many deposit money banks (DMBs), which hitherto engaged in the primary business of banking/asset management on stand-alone basis, to operate as financial supermarkets offering unfettered wide range of activities. The new model enunciated modalities for creating international, national, regional, mono-line and specialized banks in the financial sector. In addition, the DMBs that wish to retain subsidiaries are allowed to operate a holding company (national and international) structure to effectively ring-fence the core banking business within the group.

7. Furthermore, the reform also specified the quantum of capital to operate any class of the new structure. These capital prescriptions by all intents and purposes represented a subtle way of ensuring the recapitalisation of the banks within the economy. As already known to the public, to operate as regional, national and international bank, the DMBs require capitalization of ₦10, ₦25 and ₦50 billion, respectively. Also, a minimum capital of ₦15 billion is required to operate as a merchant bank with operations strictly confined to investment and wholesale banking. In addition, the CBN formally issued guidelines for the licensing and operation of non-interest banking in the first half of 2011 to expand the coverage of banking activities and promote financial inclusion within the economy. Overall, this reform is expected to facilitate a system where banks are involved only in the core banking activities devoid of the unbridled risky behaviour that contributed significantly to the recent banking crisis.

8. Another major strand of the reform initiatives was to ensure that the banking system contributes to the real sector of the economy by enhancing the availability of credit to improve business climates for employment generation and also create the conditions for the private sector to be the engine of growth. Thus, the CBN through the Bank of Industry (BOI) continued to strengthen the initiatives of improving access to financial services by the poorly financed real sector of the economy. Notable among these initiatives are: the ₦200 billion Commercial Agricultural Credit Scheme; the ₦200 billion Refinancing/Restructuring

SME/Manufacturing Funds and the Power/Aviation/Infrastructure Fund, which have been sustained to provide long-term finance for the real sector of the economy.

9. In addition, the CBN engaged the Alliance for Green Revolution (AGRA) to develop the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) to further strengthen agricultural financing strategies to boost output, increase farmers' income, create jobs and provide wealth opportunities across the value-chain. Let me emphasize that the whole essence of the NIRSAL is to spur the agricultural industrialisation process through increased production and processing of the greater part of the commodities produced across the nation.

10. Distinguished Ladies and Gentlemen, you will agree with me that the global financial crisis of 2007 – 2009 has demonstrated that financial integration, not only brings benefits, but also allow shocks to be transmitted more easily across continents and nations. The realisation of this has therefore, necessitated the continuing search for copious solutions, particularly by the industrial economies, to ensure a more resilient and efficient financial system as well as a financial stability framework that would minimise exogenous shocks and insulate the global financial system from contagion.

11. Moreover, recent developments around the globe particularly, with respect to the US sovereign debt downgrade and the European debt crisis which negatively affected the credit ratings of Greece, Portugal, Spain and Italy among others, have further underscored the urgent need to strengthen the global financial system, in general, and those at the regional and national levels, in particular. It is not surprising therefore, that the European Union led by Germany and France has spearheaded the moves to recapitalise fragile banks across Europe and one of such move was the injection of €4.0 billion fund approved for the Belgian bank Dexia, among others.

12. As you are aware, Nigeria is also affirming her resolve to strengthen the financial system, particularly by stemming bank failure, curbing systemic risks and containing contagion. To ensure this, the Bank revoked the licences of the three most fragile banks, namely Bank PHB Plc, Spring Bank Plc and Afribank Plc, following, which the NDIC incorporated three (3) 'bridge banks', namely Keystone Bank, Enterprise Bank and Mainstreet Bank, respectively, to assume their assets and liabilities. The move was not only to stabilise the banking sector and

avert systemic risks, but was also designed to save thousands of jobs that otherwise would have been lost if the 'bridge banks' mechanism was not implemented, as a matter of urgency.

13. Let me remind you that one of the most arduous problems confronting the Nigerian economy today is that of growth without employment (jobless growth phenomenon) which requires a very urgent attention. It is my fervent belief that the pursuit of financial innovations to aid the real sector can greatly improve the employment content of Nigeria's GDP growth. To this end, the Bank will continue to promote the policy of financial inclusion to engender the provision of universal access to finance at reasonable cost and a wide range of financial services to everyone so that more jobs will be created for the teeming population.

14. Ladies and Gentlemen, with these remarks, I presume the stage has been set for incisive deliberation on how to fashion-out new strategies to foster financial sector development that will continue to drive sustainable economic growth and development in Nigeria. I am aware of the assemblage of eminent resource persons to lead the discussions and I, therefore, challenge you all to brainstorm and come-up with plausible recommendations and suggestions that would support the financial sector and ultimately spur economic growth and development.

15. I wish you all a very fruitful deliberation and thank you for your attention.

Special Remarks

Sarah O. Alade, Ph.D[*]

The Governor, Central Bank of Nigeria,
Deputy Governors,
Departmental Directors,
Branch Controllers,
CBN Executives,
Distinguished Resource Persons,
Ladies and Gentlemen.

1. It is my honour and pleasure to make these special remarks at this opening ceremony of the 19th edition of the annual in-house Executive Seminar organised by the Research Department in collaboration with the Human Resources Department. As usual, the Seminar is aimed at availing the Executives of the Bank the opportunity of brainstorming on contemporary issues in the domestic and global economies. In this regard, the theme of this year's Seminar "**Financial Sector Development, Economic Growth and the Nigerian Economy"** is quite germane, given the current efforts of the Bank in repositioning the sector to play its catalytic role of financial intermediation and financing growth.

2. Indeed, a well-developed financial sector plays an important role in the overall economic development of any country. This is why many countries in the world have undertaken one form of financial sector reform or another over the past decades to minimise vulnerabilities, which often result in financial crises, economic slowdown and huge fiscal costs. The goals of such reforms are always directed at invigorating the economy and putting it on the path of sustainable growth. It is within this context that the significance of the theme of this year's Seminar can also be situated.

3. Theoretical and empirical studies on the nexus between finance and economic growth are replete in the literature. Empirically, there are three strands of opinion on the nexus between financial development and economic growth. The first is premised on the view that the direction of causal relationship proceeds

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[*] Dr. Mrs. Alade is the Deputy Governor, Economic Policy, Central Bank of Nigeria.

from financial development to growth. The second is that growth impacts financial development, while the third embodies a symbiotic view of a bi-directional causality between financial development and economic growth.

4. Modern growth theory identifies two specific channels through which the financial sector might affect long-run economic growth, namely its impact on capital accumulation (including physical as well as human capital) and the rate of technological progress. These effects arise from the intermediation role provided by financial institutions, which enable the financial sector to mobilise savings for investment, facilitate and encourage inflows of foreign capital and optimise the allocation of capital between competing uses.

5. Experience in some countries has shown that the financial sector, if properly developed, could serve as an engine of growth through the promotion of rapid economic transformation of a nation. Another important role of the financial sector is the redirection of savings from a less desirable form to a more desirable one; e.g. from a relatively liquid and short-term form to a relatively longer-term form.

6. Financial sector development can be measured by its efficiency and competitiveness, range of financial services that are available, diversity of institutions which operate in the sector, amount of money that is intermediated through the sector, the extent to which capital is allocated to private sector, the response to market signals and regulation, and stability of the sector.

7. Distinguished Ladies and Gentlemen, let me state that the financial services industry can only support economic growth if the financial institutions are largely sound and efficient, and have proper governance structures that would guarantee investors' confidence in the system. The main anchors for the attainment of these objectives essentially relate to proper financial regulation and supervision as well as the overall institutional and legal framework governing contractual relationships among economic agents.

8. In Nigeria, the evolution of the financial sector has had a chequered history in terms of stability and instability. Prior to the reforms of 1986, the financial sector in Nigeria was highly repressed. Interest rate administration, selective credit controls, ceilings on credit expansion and use of reserve requirements and other

direct monetary control instruments were typical features of the banking sector. Entry into banking business was restricted and semi-public or government agencies owned majority of the financial institutions that dominated the financial services industry, such as banks and insurance companies. Operations in the sector were a lot riskier as there was no deposit insurance to provide safety net for depositors. The financial environment was generally inefficient, illiquid and insolvent, as evidenced by negative capital adequacy ratios and complete erosion of shareholders' funds, leading to lower return on assets.

9. The neo-liberal era witnessed the dismantling of the regime of economic and financial controls to pave way for increased reliance on market forces in 1986, in line with the general philosophy of economic management under the Structural Adjustment Programme (SAP). The reform measures implemented included, deregulation of interest and exchange rates control, removal of sectoral credit allocation and removal of restriction on free entry into banking business subject to meeting the conditions for obtaining a banking licence. A major reform was the establishment of the Nigeria Deposit Insurance Corporation (NDIC) in 1988 to provide safety nets and strengthen the regulatory and supervisory framework. The liberalization of the financial system, no doubt, engendered reasonable level of competition among the banks. But with a paucity of good managerial prowess and unbridled growth in financial institutions and instruments, systemic distress that was akin to those witnessed in the days of zero regulation of banks set in. The development led to high rates of inflation, large government deficits, inadequate capital base as well as fraud in the financial institutions, particularly banks, resulting in its limited impact in terms of improvement in the efficiency of the allocation of resources in the economy.

10. In response to these problems, the CBN in 2004, initiated and implemented another reform in the sector – the Bank Consolidation Programme. The thrust of the policy was to grow the banks and position them to play pivotal roles in driving development in other sectors of the economy, as well as induce improvements in their operational efficiency.

11. Furthermore, the capital market was deregulated, prudential guidelines were issued to compel banks to adopt a uniform standard for risk asset classification and loan loss provisioning and the indirect monetary policy instruments were adopted. In addition, the mandate of the Bank, as derived from

the 1958 Act of Parliament, has been amended in 1991, 1993, 1997, 1998, 1999 and 2007 to confer greater powers on the CBN in the areas of banking supervision and examination, monetary management and enforcement of prudential standards in the banking industry.

12. In terms of market developments, the Bank carried out a number of reforms in the Nigerian payments system and continued to ensure effective monitoring of existing and planned payments system initiatives. Consequently, there have been improvements in the payments system. For instance, the clearing cycle has been reduced from 21 working days to T + 2 and efforts are being made to further reduce it to T + 1. In addition, the banking environment has become increasingly competitive as evidenced by the emergence of various banking products such as electronic payment cards and products, including automated teller machines (ATMs), point-of-sales (POS), debit cards, credit cards, internet banking, telephone banking, and mobile banking. The Bank developed and issued guidelines to operationalise all these products. Furthermore, the Bank had licensed a central switch to carry out all switching transactions in the country.

13. Distinguished ladies and gentlemen, in the wake of the recent global financial crisis, and in realisation that financial instability can affect the macroeconomic environment with adverse consequences for economic activity, price stability and the monetary policy transmission process, the Bank articulated a blueprint for reforming the Nigerian financial system, in general, and the banking sector, in particular, in the next ten years. The blueprint tagged "**The Alpha Project Initiatives of the CBN"** was built on four pillars of enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution and ensuring that financial sector contributes to the real economy.

14. Consequently, the Bank is intensifying efforts towards strengthening regulatory and supervisory framework and enhancing monitoring of the operations of the Deposit Money Banks (DMBs) to ensure that they remain safe, sound and healthy and contribute to the growth and development of the economy. In addition, the recent Cash-less Policy of the Bank is aimed at addressing the currency management challenges in Nigeria, as well as enhancing the payments system. The Nigerian economy is heavily cash-oriented in the transaction of goods and services. The huge cash transaction increases the

operational costs of the banking sector, which is passed down to the customers in the form of high service charges and high lending rates. As Executives of the Bank, we are expected to explain to the public the rationale behind most of its policy stance so as to reduce rumours and speculations.

15. The number of bank branches had increased from 3,247 in 2003 to over 5,837 in 2010, while employment in the sector rose from 50,586 in 2005 to 71,876 in 2010. Overall, the financial development efforts have engendered stable macroeconomic environment evidenced by the relatively high GDP growth rate, low inflation, relatively stable interest and exchange rates and enhanced capacity to further support growth in the economy.

16. Distinguished ladies and gentlemen, there is no doubt that these reforms and initiatives have taken financial development in Nigeria to a new height. The types of institutions offering financial services, aside from the conventional banks, now include other financial institutions such as the discount houses, primary mortgage institutions, microfinance banks, finance houses, non-interest banks and development finance institutions, etc. The number of financial products has also increased and includes the use of e-money products such as web payment (internet), point-of-sale, mobile payments, among others. The depth of the financial sector, as measured by the ratio of broad money supply (M_2) to GDP increased to 42.7 and 38.9 per cent at end-December 2009 and 2010, respectively, compared with 23.4 and 19.8 per cent at end-December 2003 and 2004. The intermediation efficiency of the banks, as measured by the ratio of currency outside banks to broad money supply, improved, as it fell to 9.7, 8.6 and 9.4 per cent at end-December-2008, 2009 and 2010, respectively, from 20.8, 20.3 and 20.0 per cent, at end-December 2003, 2004 and 2005.

17. Although the Nigerian financial services environment has improved significantly following the reform efforts of the CBN, critical questions regarding their further development for increased economic growth and development remain. These include the need for: intensive efforts at deepening the reforms in the financial sector, facilitating rural financial reforms in order to achieve financial inclusion in the economy, developing the capital and insurance markets, legal reforms, issues of frequent distress in the system, huddles in liquidation process and payment of private depositors, insecurity of life and property, and strengthening supervision of financial institutions to avert systemic distress in the country.

18. In the light of the foregoing, I once again, urge you participants in this very important Seminar, to critically examine the issues and come up with appropriate recommendations that will assist the Bank, as both a regulatory/supervisory authority and monetary policy maker, in overcoming the challenges posed by the deregulation/liberalisation of the financial environment in particular, and advances in IT and globalisation, in general.

19. We have carefully selected experts and seasoned professionals and academicians in the relevant fields as facilitators for this Seminar. I have no doubt in my mind that they will do justice to the issues involved and by the end of their presentations, you will be better informed. Once again, I urge you to make use of this opportunity by devoting maximum time and attention to all the deliveries and actively participate in all discussions.

20. Before concluding these remarks, I wish to thank the Governors for honouring our invitation to grace this occasion and the tremendous support he has given the Department, in particular. I wish you all a rewarding Seminar and fruitful deliberations.

Thank you for your attention.

Financial Sector Development and Economic Growth: A Theoretical Exposition

Professor Peter N. Umoh*

Abstract

The various literature and studies reviewed in this exposition have underscored the positive impacts of a developed financial sector on an economy. Whilst a few studies showed that finance follows growth, the majority opinion is that finance leads growth. Unfortunately, growth has not led to economic development in many developing economies, necessitating intervention by such bodies as the United Nations, International Labour Organization and United Nations Development Programme. Economists are equally concerned about this development and have, therefore, conducted studies to show the relationship between economic growth and poverty alleviation. They generally agreed that growth is good for poverty reduction.

I. Introduction

It is conventional to see an economy as consisting of the real sector and the financial sector. Whilst the real sector typically has goods and related services, the financial sector consists of financial markets, instruments, telecommunication facilities and market participants (individuals and institutions) involved in the process of financial intermediation. The relationship between the real sector and the financial sector of an economy as the economy grows has been a subject of great interest to economists and policy makers. A century ago, Schumpeter (1911) had argued that financial intermediation through banks plays a pivotal role in economic development through banks' role in allocating savings to projects with the best chances of success. Since then, there had been numerous studies seeking to establish the role that a financial sector plays in the process of economic growth and development.

The objective of this paper is to examine some of the major studies to derive some theoretical basis for the relationship between financial sector development and economic growth. Furthermore, the paper examines some topical issues in financial sector development as well as share thoughts on the seeming

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aberration that economic growth fails to lead to economic development in many developing economies.

The paper is organised in five sections. Following this introduction, major issues in financial sector development are reviewed in Section 2, while Section 3 highlights major studies and findings in respect of the relationship between financial sector development and economic growth. Section 4 reviews some related literature on growth and development. The paper is concluded in section 5.

II. Financial Sector Development

The financial sector was earlier characterised as consisting of markets, instruments, communication facilities and market participants involved in financial intermediation. The participating institutions are largely made up of operators and regulators with the common objective of efficiently mobilising financial resources from the surplus units (SSUs) for use by the deficit units (DSUs), employing appropriate financial instruments and working through competitive markets. Thus, the saving function in the economy is separated from the investment function with the result that both functions are better performed and the quantum of national saving/investment increases. The increase in total saving benefits from improved opportunity to save, interest-elasticity of saving effect and direct institutional effect where institutions are available, enhances marginal propensity to save (Lewis,1955).

The functions of a financial system have been described by Levine (1997) to include: mobilising savings, allocating capital funds, monitoring the use of funds, and managing risk. Stiglitz (1998), in noting the complex functions of finance, associated the financial system to the "brain" of the economy that performs the task of resource allocation across space and time in an uncertain environment. These functions are better performed the more the financial sector develops.

The financial sector is said to have developed if it attains operational efficiency, which requires that the sector has a large number of participants, including institutional members with specialised functions; a variety of instruments differing in tenor, amount and risk; markets that react promptly and sometimes instantaneously to available information (Fama's 1965) and competent regulatory authorities that understand, supervise and promote the markets.

The development of the financial sector of an economy can also be gauged by the level and rate of growth of financial assets relative to national income. In the literature, reported studies typically use the ratio of broad money to national income (M_2/Y) or the growth rate per capita of real money balances (Jao, 1976; Fry, 1978; and Ogun, 1986). The higher the quantum of financial assets relative to national income, the deeper or more developed is the financial sector. Typically, the financial assets included in cross-country studies were: broad money (M_2), financial assets of banking institutions, treasury bills, market value of traded shares in the stock exchange and money market funds. The problem in such studies, however, is that in many developing economies, particularly in Africa, the data on some of these assets are not available and where available, not consistent. Nonetheless, some cross-country studies of financial deepening in sub-Saharan African countries (Easterly and Levine 1994; Sachs and Warner 1995; and Ndebbio 2000) showed low levels for the ratio of financial assets, mainly M_2 to national income (Y). For the 1980 decade, the ratios ranged from the lowest of 2.8 per cent to the highest of 51.5 per cent. In developed economies, where the ratios reflect all financial assets, not merely broad money, the ratios are quite high. Meier (1984) reported that in the United States of America the ratio increased remarkably from about unity, that is, 100.0 per cent at the beginning of the last century to about 450.0 per cent in the 1980s. For Japan, the ratio is reported to have increased from 10.0 per cent in 1885 to over 150.0 per cent in the 1980s. It has been widely observed that as countries grow richer, they equally become richer in financial assets, institutions and markets such that financial assets grow faster than national income.

The Nigerian experience should not be different as a number of studies on financial deepening have tended to produce consistent results when similar methodologies were employed (Adewunmi 1997, Ndebbio 2000, Onwioduokit 2006). Much earlier, Ojo and Adewunmi (1982) computed the level of financial deepening in Nigeria for the period 1969 to 1975 using assets of financial institutions expressed as a proportion of gross national product and the average ratio ranged from 36.0 per cent to 55.0 per cent. Iganiga and Enoma (2009) used the ratio of broad money (M_2) to gross domestic product for the period 1980 to 1998 and the computed ratios ranged from 26.7 per cent to 22.8 per cent. The authors concluded that the declining ratios indicated that "financial sector reforms in Nigeria did not achieve the purpose of financial deepening that is purported by theory." The conclusion could be considered as being hasty given the methodology that used only broad money and omitted other financial assets in the economy, particularly as financial deepening had been defined as an increase in the supply of financial assets in the economy.

There is no doubt that the quantum of financial assets had grown remarkably in Nigeria as the economy had grown over the years. For example, in 2010 the nation's gross domestic product at current market prices was ₦29.5 trillion, while total assets of banks inclusive of off-balance sheet engagements stood at ₦18.6 trillion, given a ratio of total assets to gross domestic product of 63.0 per cent. Total assets of banks stood at ₦7.2 trillion, while loan asset to GDP ratio was 24.4 per cent (NDIC 2010). These figures did not include outstanding treasury bills, money market funds and the total value of capital market instruments. In the capital market, for example, market capitalization which stood at a peak of ₦10.2 trillion in 2007, declined to ₦6.96 trillion and ₦4.98 trillion in 2008 and 2009, respectively. Given the GDP at market prices of ₦22.9 trillion in 2007, the value of stocks to GDP for that year was 44.5 per cent. Therefore, a comprehensive study of the Nigerian economy that captures the value of financial assets in the money and capital markets is most likely to show a high level of financial deepening and greater growth in financial assets than the growth in national income over the years.

III. Financial Sector Development and the Economy

How a developed financial sector impacts on the economy has been a matter of continuing interest to economists since Schumpeter raised the issue a century ago. Generally, growth theorists appear to agree that financial sector affects the economy through its impact on capital accumulation and the rate of technological progress. There is sufficient evidence in the literature to support the theory of strong linkages between financial sector deepening and economic growth. However, there are a few studies that question the direction of causation. Such studies attempt to show that financial sector development does not necessarily lead to economic growth, but that economic growth leads to financial sector deepening through increased demand for financial services.

Bagehot (1873) postulated that the financial system played a critical role in English economic growth by mobilising the needed capital for development. However, Schumpeter (1911) argued strongly that well-functioning banks spurred technological innovation by identifying and funding projects with the best chances of success with benefit to the economy. In 1955, Lewis, an early pioneer of development economics, suggested a two-way relationship between financial deepening and economic growth. He argued that financial markets developed as a result of economic growth and that the developed markets in turn stimulated real growth.

Gerschenkron (1962) propounded a "Structuralist Hypothesis" and argued that the modes and patterns of financing by banks vary according to the relative backwardness of an economy and its structural peculiarities. In advanced economies, he argued that capital needs are likely to be met outside the banking system, that is, from financial markets. In moderately backward economies, such need would likely be met by specialised banks rather than commercial banks. In extreme backward economies, banks' contribution to capital formation is likely to be negligible; consequently government would have to provide the finance needed for capital formation.

Patrick (1966) proposed the "Stage of Development Hypothesis" wherein he argued that a financial sector deepening engenders economic growth at the early stages of economic development, but that the impact decreases as the economy grows. Thereafter, the growth in the economy begins to impact on financial development. Gurley and Shaw (1967) argued that economic growth leads to financial deepening because the growth generated increased demand for financial services. Such demand precipitates financial deepening and direction of causation is from economic growth to financial growth.

Goldsmith (1969) conducted his seminal study using data on 35 countries from 1860 to 1963 and found evidence of a relationship between financial deepening and economic growth over this period. He observed that the financial superstructure of an economy accelerates economic performance to the extent that it facilitates the migration of funds to places where they yield the highest social return. However, Goldsmith was reluctant to assert that financial development had a causal influence on economic growth because he considered that the methodology was not robust enough to arrive at a conclusion. He, therefore, challenged the next generation of economists to resolve the causal relationship question.

McKinnon (1973) and Shaw (1973), proponents of the "Financial Repression Hypothesis" highlighted the negative impacts of financial controls and the gains of free markets. The duo fervently believed that a free financial sector would contribute immensely to economic growth. They argued that such contribution would only be absent if the financial sector is repressed. They referred a repressed financial sector as "shallow finance" and a liberalised one as "deepening finance". These findings provided the theoretical basis for widespread adoption of financial liberalisation and reforms in developing economies. Their work further provided support for the structural adjustment programmes of the International Monetary Fund (IMF) and the World Bank (WB) in the 1980s.

Much analytical work has been done since Goldsmith (1969) challenged economists to resolve the question of the causal relationship between financial development and economic growth. For example, King and Levine (1993), in a study of 80 countries spanning 1960 to 1989, using different measures of financial development, found strong and positive relationship between the financial measures and economic growth. They argued that "higher levels of financial development are significantly and robustly correlated with faster current and future rates of economic growth, physical capital accumulation and economic efficiency improvements … and that finance does not only follow growth: finance seems importantly to lead economic growth".

Other economists have used more sophisticated techniques to address the question. For example, Levine, Loayza and Beck (2000) had results, which confirmed that financial deepening has major impact on economic growth. Similarly, Calderon and Liu (2003) used what has been styled innovative techniques on data from 109 countries for the period 1960 to 1964. Their results showed bi-directional causality, but the impact of finance on growth was reported to be more important than that of growth on finance, particularly in developing economies. In the literature, it was reported that over longer periods, the impact of growth on finance was becoming insignificant.

Literature has revealed a number of studies for sub-Saharan Africa (SSA). Such studies had used cross-country data for several countries to estimate the relationship between financial development and economic growth (Jao 1976; Fry 1978; Ogun 1986; and Ndebbio 2000). The studies were limited by the paucity of consistent data on key variables of interest. For example, it was only when Jao (1976) used the ratio of M_3 to national income that the coefficient of financial development was significant for six SSA countries. In Ndebbio (2000), financial deepening was found to positively impact per capita growth of output.

However, while the result of Ndebbio's financial deepening explanatory variable had the right sign it was "insignificantly less satisfactory". The author attributed the finding to the presence of "shallow finance" and the absence of well-functioning capital markets in the SSA countries studied.

IV. Economic Growth and Economic Development

Typically, an economist is likely to define economic growth as a sustained increase in the national income whether that income is measured as Gross Domestic Product (GDP) or Gross National Product (GNP). Economic development on the other hand refers to the positive impact of economic growth on key issues like unemployment, poverty and inequality. Economic growth is, therefore, a necessary but not a sufficient condition for economic development.

Given its concern for economic development in poor member countries, the United Nations (UN) declared the first decade of the 1960s as the "Development Decade". The UN went ahead to prescribe a growth rate of 6.0 per cent for the Less Developed Countries (LDCs). The expectation was that if the LDCs were to grow annually at that rate, they would achieve economic development. The economic growth was expected to have a trickle-down effect on the welfare of the people. Fortunately, some LDCs including Nigeria, met the 6.0 per cent growth rate, but unfortunately, the welfare of their people did not improve as unemployment, poverty and inequality remained high.

Expectedly, some scholars started to question the notion of equating economic growth with economic development if the growth did not lead to improve the welfare of the people (Dudley, 1969). The scholars argued that economic growth and economic development were expected to address the challenges of the growing gap between the rich and the poor as well as ensure gender equality, without which inequality and misallocation of national resources would result.

In the 1970s, the International Labour Organization (ILO) promoted the "Basic Needs Approach" to development. The ILO viewed development as involving the provision of basic essentials required for civilised living such as shelter, food, clothing, basic education and basic health care. These basic needs were expected to be provided by government whether or not the economy was growing.

Since the 1980s, the United Nations Development Programme (UNDP) has advocated human development as being at the centre of any nation's developmental process. It defined human development as a "process of expanding human choices by enabling people to live a long, healthy and creative life". The organisation published the Human Development Report with Human Development Index (HDI) which compared human development across countries. Governments all over the world take keen interest in this publication as it enables them to compare their countries against their peers in the area of human development.

Buoyed by the contributions of ILO and UNDP, economists have continued to study the relationship between economic growth and human development. Most of the studies target poverty reduction as the economy grows. The widespread opinion amongst economists is that growth is necessary, though not sufficient condition for sustained poverty reduction. Although cross-country studies show differences in the relationship between economic growth and poverty reduction, the studies, however, showed that the incomes of the poor tend to rise (fall) proportionately with average income (Dollar and Kraay 2001; Eastwood and Lipton 2001).

In their study of 26 countries, including 16 developing economies, Jalilian and Kirkpatrick (2001) examined the link between financial development and poverty. The results of the study suggested that a percentage increase in financial development raises the incomes of the poor by about 0.4 per cent. These studies on poverty reduction relate to the role of "conventional finance" primarily from commercial banks.

Special financial programmes targeted at the poor have in recent times contributed immensely towards poverty reduction in those LDCs where such programmes exist. In Bangladesh, for example, a study by Khandker (1998) of three micro-finance banks in that country found that 5.0 per cent of borrowers from the banks lifted their families out of poverty every year. The study, also found evidence of increase in self-employment in the villages the borrowers resided. In Bolivia, MkNelly and Dunford (1999) found that two third of clients of a credit and education programme had higher incomes after joining the programme. In Indonesia, Remenyi and Quinones (2000) observed that borrowers of the microfinance credit programme increased their incomes by 12.9 per cent, compared with 3.0 per cent increase for non-borrowers. However, Holden and Prokopenko (2001) argued that the loan portfolios of the microfinance institutions were sometimes poor because of inept management and that the institutions charged high rates of interest on loans because of the absence of competition.

There is dearth of studies on the impact of microfinance banks in reducing poverty in Nigeria. The development could be attributed to the fact that the banks are relatively new entrants into the Nigerian economy. Also, economists and other interested stakeholders might have found that data on the operations of these institutions were not readily available. However, microfinance banks in Nigeria, in spite of the difficulty they have in accessing funds for on-lending, have quite a role to play in reducing poverty. Some of these banks are able to reach out to rural farmers/traders and assist them with needed business funds without collateral. The report was that this group of borrowers meet their loan repayment obligations, unlike the professional borrowers in the cities.

Microfinance banks are in a position to significantly and positively contribute to Nigeria's economic development if properly structured and supervised. The meager resources with them can go a long way in this direction. For example, at the end of 2010, the country had 866 of these banks with operating licences and 121 with provisional licences (NDIC, 2010). The banks are reported to be mostly in urban and semi-urban areas. The Central Bank of Nigeria (CBN) should endeavour to license more rural microfinance banks.

According to statistics from the NDIC, 538 of the 866 microfinance banks rendered required returns to the Corporation in 2010. The analysis of the returns showed that their total loans and advances stood at ₦41.92 billion. If these funds had gone to those who ordinarily would not have been able to access commercial bank loans, then there is hope for the economy and for the poor.

V. Conclusion

There is ample evidence to support the proposition that financial development impacts positively on economic growth. Even if finance follows growth as a few studies show, the importance of the finance sector for development cannot be ignored. That economic growth is possible without economic development is a matter of concern to economists, the United Nations and governments, particularly of the affected LDCs. Economists who have sought to find the relationship between economic growth and poverty reduction have generally agreed that growth is good for poverty reduction. In this connection, the important roles that micro-credit institutions can play as they do in some Asian countries was stressed.

Nigeria's performance in poverty reduction can be increased if microfinance banks are refocused from urban and semi-urban centres to the rural areas. There is need for government to make funds readily available at concessionary rates to the MFBs for on-lending to the poor and small businesses. The CBN as the lead regulator in the financial system still has important role to play in financial sector development. Finally, economists need to do more work to provide greater understanding of the nation's economy. Dearth of relevant data can no longer be an excuse for not fully understanding how deep financial system is and how the system can contribute to national development.

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Financing Nigeria's Growth after the Global Economic Crisis within the Perspective of Vision 20:2020 and The Transformation Agenda

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Abstract
The paper adopts content analysis method to investigate the underlying assumptions of the Pillar of Growth within the framework of Nigeria Vision 20:2020 (NV20:2020) and the Transformation Agenda. The aim is to show how realistic are the underlying assumptions and whether or not the available structure/measures of the financial system would be sufficient to finance the Vision. The conclusion is that the present Transformation Agenda and indeed the Medium-Term Implementation Plans adequately provide for the financing of NV20:2020 if the provisions of the documents are strictly adhered to.

I. Introduction

I.1 General Background.

The tradition of *capital accumulation* through investment has long, before the economics of Adam Smith, been identified as the engine of economic growth (Hayami and Godo; 2005). However, the major debate is associated with the extent to which the State is allowed to provide the needed capital required to leapfrog the economy to the desired growth trajectory (Todaro and Smith; 2010). While some analysts argue that the State be allowed to only ensure that the market works and not be a player in the market system, others opined that the market in some under-developed economies (like Nigeria) do fail and so the State should be allowed to be the main player. Even where the extent to which the State is to be allowed to interfere is quantified, there could still be some challenges, especially, with regard to the capacity of the financial market to mobilise the complementary funds required to meet up with the investment needs of a particular development plan. The relative prospect of financing Nigeria's Vision 20:2020 is a typical instance of this situation.

In its effort to reposition the Nigeria's economy on a growth trajectory required to be among the 20 largest economies of the world in 2020, the total investment

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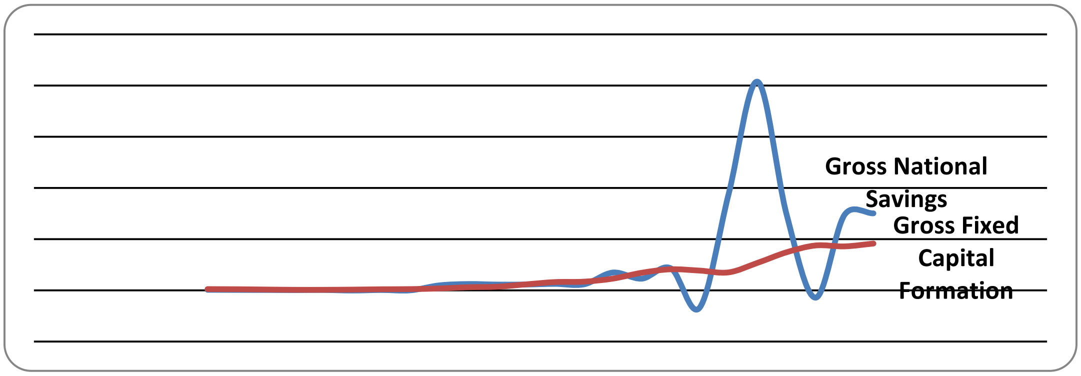
outlay of ₦32 trillion is required, out of which the Federal Government and sub-nationals would provide ₦19 trillion for investment in some designated projects in the First National Implementation Plan (1st NIP 2010 – 2013), while the private sector would invest ₦13 trillion to complement public sector investment. This is the first of the three streams of medium-term investment framework (2010 – 2013, 2014 – 2017 and 2018 – 2020) under the NV20:2020. The challenge is whether Nigeria's financial markets (formal and informal) could really mobilise such funds on a sustainable basis.

While the Government (Federal and State) can source its needed funds for the investment through taxes, sale of natural resources and State Owned Enterprises (SOE), borrowings from domestic and international sources (through money and capital markets) and reserves, the sources available to the private sector are limited. Basically, the private sector can only source its needed funds through foreign direct investment, money and capital markets or from its reserves.

The challenges inhibiting the private sector from getting enough funds for investment are quite enormous. The world is just recovering from a recession and so there is paucity of capital globally even the cost of acquiring capital is quite high. Besides the propensity to save from disposable income, most countries of the world experienced a slowdown in economic growth, thereby making it difficult to mobilise enough savings from surplus spenders. In addition, while the formal sub-sector of the Nigerian financial system has the potential to mobilise funds from surplus spenders, the informal sub-sector is highly fragmented and could at best do little. More challenging is the under-developed nature of the Nigerian financial market. The Government also competes with the private sector for funds available in the financial market, thereby crowding out the private sector investment.

Available evidence showed that savings rate was low and investment rate was even lower as the savings-investment gap was wide in Nigeria. Figure 1 below shows the trend of savings and investment in Nigeria from 1981 to 2005. It is clear from the figure that the savings trend was higher than investment all through the period.

Figure 1: Gross National Savings and Gross Fixed Capital Formation (1981-2005)



Source: 2008 CBN Statistical Bulletin.

I.2 Relevance of Financial Sector to Growth and Development

The financial sector is very critical to the development and growth of a nation's basic industry such as the manufacturing. Economic activities are facilitated by credit availability. Therefore, the financial sector has to be properly positioned to provide the required credit for the nation's economic activities by creating an appropriate and conducive environment and infrastructure. Economic development usually requires huge investments that are often not readily available to a single economic entity. Hence, financial capital is one of the fundamental requirements for economic development. It is also important for effective build-up of both physical and human capital.

Investible funds are usually scarcely and sparsely available, because of the information asymmetry between excess savers and borrowers and the increase in transaction cost of funding as well as risk of default for all parties. The financial sector needs to provide resources for funding long-term low-profit projects like education, agriculture and health through financial intermediation. However, these projects would not receive adequate attention because it requires long-term and low interest rates to be profitable. Hence, this critical sector would suffer without adequate attention given to them by the financial sector.

I.3 Objectives and Research Question

Having mentioned some of the challenges facing the private sector in the acquisition of funds needed to play its part in the NV20:2020, the objective of this paper is to analyse the feasibility of generating ₦32 trillion to finance the Vision and Transformation Agenda of the Government given that the world is just recovering from a recession. It is also to evaluate the consequences of the scramble for the available loanable /investable funds by the Government and the private sector.

Thus, the question this paper attempts to answer is whether or not the financial system is robust enough to mobilise the huge financial resources required to fund the projected investment outlay in the Vision and Transformation Agenda of the Government without compromising some compelling needs of the economy.

The paper is divided into six sections. Section one is introduction. Section 2 highlights the assumptions underlying NV20:2020 and the 1st NIP with the aim of analysing the possible challenges likely to be faced in implementing the Vision. Section 3 discusses the theory underpinning the objective of the paper. Some pertinent issues, arguments and challenges associated with the assumptions of both NV20:2020 and 1st NIP is highlighted in Section 4. Section 5 gives indication of the financing strategy of the Vision as discussed in the Transformation Agenda of the present Administration. Section 6 draws up conclusions and makes some policy recommendations.

II. Nigerian Economy and NV20:2020: The Underlying Assumptions about the Financial System/ Macroeconomic Variables

In an attempt to attain the growth trajectory required to obtain a minimum GDP of US$900 billion and a per capita income of at-least US$4,000 per annum by 2020 (the growth pillar of the NV20:2020), the economy would need to grow at an average of 13.8 per cent from 2010 to 2020. These targets are based on some assumptions about the fundamentals of the economy. Also, to achieve an average growth rate of 12.4 per cent per annum from 2010 to 2013 and a GDP at current prices of ₦50.9 trillion in 2013, the 1st NIP, further specified some assumptions about the fundamentals of the economy. A review of the assumptions underlying the Vision document is needed to show how feasible it is to mobilise and channel ₦13 trillion from surplus spending unit of the economy to the deficit spending unit for investment in the private sector of the economy from 2010 to 2013.

The Vision document has three basic pillars: the pillar of productivity and wellbeing; economic growth; and social and economic development. There are also a number of assumptions underlying the projections of each of these pillars. This paper focuses on the pillar of economic growth with the following strategic objectives:

- stimulate primary production to enhance the competitiveness of Nigeria's real sector;
- significantly increase production of processed and manufactured goods for export;
- stimulate domestic and foreign trade in value-added goods and services; and
- strengthen linkages among the key sectors of the economy.

II.2 Assumptions Underlying the Pillar of Growth in the NV20:2020

A brief review of the assumptions underlying the *Growth Pillar* in the NV20:2020 document is required towards having a better appreciation of the targets of the growth of the economy. The following are some of the basic assumptions:

a. private sector credit as a percentage of GDP would grow from 17.0 per cent in 2009 to 30.0 per cent by 2015 and 45.0 per cent in 2020;

b. manufacturing sector contribution to GDP would grow from less than 4.0 per cent in 2009 to 10 per cent and 25 per cent in 2015 and 2020, respectively;

c. average local content value (materials and human resources) across the key industries would increase by 50.0 per cent and 70.0 per cent in 2015 and 2020, respectively; and

d. Steel consumption per capita would grow from less than 10.0 per cent in 2009 to 40.0 per cent and 100.0 per cent by 2015 and 2020, respectively.

Another set of important assumptions underlying the targets of the 1st NIP Investment Framework (2010 – 2013) are as follows:

a. the Nigerian economy will be partly influenced by developments in the international economy, which is expected to show strong recovery at a projected 4.0 per cent global growth rate;

b. the naira exchange rate to the US Dollar in 2010, 2011, 2012 and 2013 would be ₦147.00, ₦146.50, ₦146.00 and ₦145.00, respectively;

c. fiscal deficit as a percentage of GDP is 3.5 per cent in 2011 and 3.0 per cent in each of the years between 2011 – 2013; and

d. inflation rate would be single digit from 2010 to 2013 (i.e. 9.5, 9.0, , 8.5 and 8.0%, in 2010, 2011, 2012 and 2013, respectively).

II.3 Extent to which Financial Sector has funded Development Initiatives in Nigeria

The Central Bank has been pivotal, through its role as Banker to the Government. The capital market has also assisted in raising development bonds from the public to fund development plans in Nigeria. For instance, the Federal Government traded bonds to the tune of ₦2.75 billion in the capital market during December 2011. Corporate bonds and debentures traded in the market during the same period stood at ₦1.34 billion. It is also noteworthy that the financial sector has been instrumental in mobilising funds for some public private partnership (PPP) arrangements, such as the Muritala Mohammed Airport II and the Lekki Concession Company. The CBN has also played critical roles in this direction by giving attention to priority sectors in the development plan. For example, the Bank recently earmarked ₦200 billion for Agriculture. Deposit money banks and microfinance institutions have also played similar roles by mobilising funds for the private sector as well as government. International capital flows, in the form of foreign direct investment (FDI) and international remittances by Nigerians in diaspora, are also playing increasing role in the economic transformation of Nigeria. This has been made possible through the various reforms embarked upon by the Government; among which were the empowerment of Nigerian Investment Promotion Commission to boost FDI inflows to the country, the fundamental restructuring of key institutions, regulations and processes in order to attract foreign capital into the country.

Government is also currently taking steps to strengthen and energise the financial sector for effective and efficient intermediation to enhance access to credit by the investors. In addition, Government is deepening and diversifying the financial products and enhancing integration with other international financial markets. In this regard, Government established an integrated and consolidated regulating system, while putting in place a central information sharing mechanisms for all financial institutions to enhance efficiency and effectiveness in credit allocation.

III. Framework of Analysis

This section examines the underlying nexus between economic growth and financial development. In theory, the general thinking is that there exist a relationship between interest rate and economic growth; a decrease in lending rate would lead to an increase in investment rate. Among other factors, interest rate itself is a function of the demand and supply of loanable/investable funds. An increase in the supply of credit tends to bring about a decrease in lending rate and vice versa. Liberalisation of the financial market is a policy framework required for an efficient equilibration of the demand and supply of credit (McKinnon and Shaw, 1973) with the attendant effect of reduction in interest rate. The financial sector of the Nigerian economy has since 1986 been liberalised. So what are the empirical implications of this to NV20:2020?

IV. Issues, Arguments and Challenges

Given that credit to the private sector as a percentage of GDP rose from 17.0 per cent in 2009 to 30.0 per cent in 2015 and 45.0 per cent in 2020 as assumed in the NV20:2020 document, it follows that interest rate will decrease to a level that would bring about an increase in private investment. However, the question of whether or not the expected increase in private investment due to such decrease in interest rate would be ₦13 trillion (projections of 1st NIP) depends on the level of effectiveness and efficiency of the transmission mechanism in the financial system. Meanwhile, the debate concerning the relative effectiveness of the transmission mechanism of Nigeria's financial system is yet to be settled.

Given also that the projected amount of credit as a percentage of GDP would get to the private sector, it is not a sufficient reason to conclude that the private sector would ultimately invest them in the economy. There are reports of Nigerian companies producing in the neighbouring countries (Ghana and Benin Republic) due to poor state of electricity supply in Nigeria. These are unwarranted leakages that may stunt the pace of growth of the economy. Besides, private foreign investors would need to be convinced about the stability of the regulatory regimes before re-investing their net operating surplus in the economy.

The assumption about the contribution of manufacturing activities as a percentage of GDP is a derived assumption with several other composite functions. It should not be taken for granted on its own. It is linked to the assumptions of electricity power generation, local content value, per capita steel consumption and a host of others. The challenge of getting governance right is a common denominator to all these factors. It is not enough for the government to have the funds to increase power generation or put in place legislation on local content value. The political will to ensure that there's value for money and that legislations are dully enforced is critical.

Of the ₦19 trillion investment outlay expected to come from the Government in the 1st NIP (2010 – 2013), the state governments are to expend ₦9 trillion and the Federal Government ₦10 trillion. This is not enough to assume that because each of the state governments receive monthly allocation from the Federation Account then they would be able to commit up to ₦9 trillion to infrastructure development within the medium-term period (2010 – 2013) of the 1st NIP.

The fiscal federalism nature of the Nigerian economy does not mandate the state governments to commit their resources in any particular manner and they are not under any legal obligation to buy-in to the investment outlay of the Federal Government. It is, however, taken for granted that the state government will all fully buy-in to the investment plan of the NV20:2020. If some of the state governments fail to commit much of their resources towards the implementing of the 1st NIP, the Federal Government would either fill the short-fall or allow that part of the Vision to suffer. To fill such short-fall, the Federal Government may need to source funds from international sources or the domestic financial market and the implication of this is that private investment would be crowded out in the process.

V. The NV20:2020 and the Transformation Agenda

V.1 The NV20:2020

The Nigeria's Vision 20:2020 is the foundation for other medium-term plan aimed at repositioning Nigeria among the top 20 largest economies measured by GDP size of not less than US$900 billion and per capita income of not less than US$4000 by year 2020. The First National Implementation Plan (1st NIP 2010-2013), MDGs and the Government's Transformation Agenda are all medium-term implementation plans for NV20:2020. However, this Vision cannot be attained without sustained delivery of energy and other relevant forms of infrastructure in the country. The NV20:2020 also aimed at significant improvement in the quality of life of Nigerians by making people as the fundamental reason for economic growth through the achievement of inclusiveness, equity and balanced development.

The key policy thrust of its first Implementation Plan includes among the following:

- bridging the infrastructure gap to unleash economic growth and wealth creation;

- optimising the sources of economic growth to increase productivity and competitiveness;

- building a productive, competitive and functional human resource base for economic growth and social advancement; and

- improving governance, security, law and order and, engendering more efficient and effective use of resources.

V.2 Government Transformation Agenda (2011 – 2015): A Prospect for the Future

An actionable medium-term (2011 – 2015) economic blueprint known as the Government Transformation Agenda has been drafted by the present Administration to provide solutions to most of the challenges envisaged in Section IV above. The following key elements in the Transformation Agenda are to address the inhibiting factors to resource mobilisation and proper use of available funds for the projected investment outlay in the NV20:2020:

(a) Governance

The need to improve the quality of governance is the common denominator to most of the assumptions underlying the NV20:2020. It is core to most of the challenges likely to be faced by the various efforts to finance the NV20:2020.

With respect to political governance, the first amendments to the 1999 Constitution took place in 2010 and there has been reform of the electoral process, and democratic principles are also gaining ground in the resolution of political issues in the country. While there is still room for further reform, the gains of the recent electoral reforms as exemplified by the 2011 general elections are some of the instances of improved political governance.

With respect to economic and financial governance, the present Administration hopes to seek the option of cooperative fiscal federalism rather than competitive federalism to solve the challenges associated with fiscal federalism. The National Sovereign Wealth Fund is one of the cooperative fiscal federalism tools to be deployed to solve the challenges of fiscal federalism.

Among other measures to be used to strengthen governance are the following:

i. institutionalisation of an accountability framework to enable government to track its expenditure and allow the citizens to monitor government performance in the area of financial management. The various on-going Public Service Reforms and introduction of performance management are the direct measures to strengthen accountability framework;

ii. adherence to the principles of separation of powers among all tiers of government in relation to functions, responsibilities and resource allocation such that they operate harmoniously and independently of one another; and

iii. embark on value re-orientation to engender improvement in civil behaviour and social order.

(b) Funding

The need to adequately fund the Key Projects, Programmes and Policies (KPPP's) identified for a successful completion of the 1st NIP and ultimately the Vision is germane to most of the underlying assumptions of NV20:2020. The traditional sources of funding capital projects, i.e. Statutory Allocation, cannot be relied upon for the funding requirement of the government for the NV20:2020 because of its volatility as it is based on oil price that is susceptible to external shocks.

Besides, there is need to also concretise the funding sources of the projected investment outlay of private sector.

The sources of funding available to the government, on one hand, and the private sector on the other, have been clearly spelt out in the Transformation Agenda and are as follows:

i. National Sovereign Wealth Fund (NSWF)

Unlike the challenges often associated with the use of the Excess Crude Account (ECA) to fund special programmes and projects, NSWF has the buy-in of all stakeholders for its deployment to fund KPPPs under the 1st NIP and Transformation Agenda. The Fund will be adequately invested and returns from investment would also serve as a ready source of funding for NV20:2020. At a discount rate of say 5.0 per cent per annum, NSWF of say ₦1 trillion would turn in ₦50 billion. It should be noted that if the country had maintained and invested NSWF from 2007, when the ECA was as high as $20 billion, there would have been an investment income of US$4 billion.

ii. Special Intervention Funds

A number of revolving special funds for intervention in some priority sectors have been provided to the private sector by the Federal Government. The aim is to ensure that investment in the priority areas is accelerated. In line with this, the CBN has invested N500 billion in debentures issued by the Bank of Industry (BOI) under the Real Sector Intervention Fund. Proceeds from the Fund are for on-lending through deposit money banks to qualified borrowers on concessional interest rate of not more than 7.0 per cent for tenor of 10 – 15 years. Borrowers from power, small-scale manufacturing and airline sectors are the major targets for the loans. There is also the ₦200 billion Agricultural Fund established for promoting commercial agriculture enterprises. In line with such intervention measures, the Federal Government could set up special intervention fund for major capital development programmes, especially in the area of infrastructure.

iii. Pension Fund

Owing to long-term maturity of the Pension funds, the National Pension Commission (PenCom) is reviewing its regulation with a view to making capital projects in the area of infrastructure development a separate asset class that could be invested in. If this is done, it would be a potential source of funding for some of the projected investment outlay under the NV20:2020.

iv. Long-term Corporate/Commercial Bonds

Usually, loanable funds available in the money market are short-term funds that are not easily suited to the need of infrastructure development of corporate entity. To surmount this challenge, commercial banking groups have expressed desire to raise long-term (10 – 15 years) commercial bonds in the domestic or foreign markets on commercial term. In support of this initiative, commercial banks would require the CBN to provide credit guarantees that would permit the banks to issue long-term infrastructure bonds on competitive interest rates for the benefit of Federal Government.

v. Financial Intermediary Loan Scheme

The World Bank has agreed to provide a seed money of US$200 billion to set up a Financial Intermediary Loan Scheme for the purpose of providing long-term funding for capital projects development in priority areas. It is the Bank's support for the Public Private Partnership programme of the Nigerian Government. Some priority public investment/projects which accord with the 1st NIP have been slated to be funded through these sources.

VI. Key Reforms Agenda for NV20:2020

Focus of Reform toward Creating the Enabling Environment for the Private Sector to Thrive

It is not enough to strategise toward obtaining the finance required to achieve NV20:2020. There is a more important need of creating appropriate policies required to facilitate the enabling environment for generating the needed funds. The following policy directions are required for effective execution of NV20:2020:

– ***Macroeconomic Stability and Sustainable Growth***

To ensure that Nigeria's Vision 20:2020 becomes a reality, there is need to maintain sound macroeconomic stability for sustainable economic growth. To achieve this, the Government is committed to a number of macroeconomic policies required to ensure internal and external balances. In line with this, the following are the key policy prescriptions for achieving a sound macroeconomic stability going forward:

a. budgetary allocation to be based on oil price of US$70 per barrel for 2012;
b. fiscal deficit to be kept at below 3.0 per cent of GDP;
c. recurrent expenditure to be reduced from 74.4 per cent of total expenditure to below 70.0 per cent by 2015;
d. capital expenditure to be increased by 1.5 per cent per year to at least 5.0 per cent by 2015;
e. domestic debt to be kept at 16.4 per cent of GDP;
f. fertilizer, petroleum and other inefficient subsidies are to be reformed; and
g. increased focus on completing existing ongoing projects.

– ***Structural Reforms***

Privatisation, Liberalisation and Deregulation

Structural reforms of privatisation, liberalisation and deregulation are required to cut down on rent seeking activities and inefficiencies in government. This is required to save more funds for capital expenditure on infrastructure development and make the market system work appropriately.

– ***Investment in Priority Sectors Creating Jobs***

Public sector investment would be directed towards a number of job creating priority sectors to reduce the challenge of unemployment in the country.

- ***Other Reform Areas include:***

- accelerating investment in critical infrastructure;
- increased investment in human capacity development;
- deepening reforms in the public sector and delivery of social services;
- fostering private sector, powered non-oil growth and economic diversification;
- fight against corruption;
- curbing the threats to national security;
- fiscal discipline and decentralization;
- reducing the cost of governance;
- reducing red tape and bureaucracy; and
- ensuring policy consistency, coherence and effective stakeholder consultation and coordination.

VII. Key Emerging Issues and the Strategies for Addressing them

VII.1 Key Emerging Issues and Challenges

Given that a huge amount of resources are required to finance growth under the NV20:2020 and Transformation Agenda, the delivery of critical infrastructure and other development initiatives remain a major challenge in Nigeria:

- contribution of manufacturing sector to GDP is less than 5.0 per cent ;
- absence of long-term loanable funds; and
- when the credit exists interest rates are often so high.

• most of the projects requiring financing are usually very lumpy;
• limited investible resources due to the global economic and financial crisis;
• propensity to save globally slowed down due to low income growth making it difficult to mobilise savings for investment purposes;
• the fragmented nature of the informal financial sub-sector in Nigeria - a large percentage of surplus spenders in Nigeria are excluded from the formal sector,
• the public sector competes with the private sector for funds in the financial market, especially in the capital market;
• how to mobilise foreign investors to invest in Nigeria in the face of security concerns; and
• too many projects and programmes taken together at the same time in the face of limited resources.

VII.2 Strategies for Enhancing Finance for Growth and Development in Nigeria

Some of the key strategies for enhancing finance for growth and development in Nigeria include:

(i) Need to prioritise the projects in accordance with the aspirations of the NV20:2020 and Transformation Agenda;
(ii) Budgetary submission of relevant Ministries, Departments and Agencies (MDAs) to be aligned with the priorities of NV20:2020 and Transformation Agenda;
(iii) Need to provide political will - Government has demonstrated political will to sustain on-going reforms in the country;
(iv) Renew fight against corruption in the public and private sectors;

(v) Policy consistency and long-term strategic planning framework - NV20:2020, First NIP and the Transformation Agenda;
(vi) Strengthening regulatory framework of the financial sector;
(vii) Avoid a plethora of projects by prioritising in line with the available resources to avoid abandoned projects; and
(viii) Need to institutionalise the national monitoring and evaluation (M and E) system at all levels - to facilitate effective implementation of the NV20:2020 and Transformation Agenda

IX. Conclusion and Recommendations

The government as well as the private sector have financing roles to play in Nigeria's on-going perspective plan known as the NV20:2020. The aim is to make the country to be among the top 20 largest economies of the world by the year 2020. There are underlying assumptions, which are fundamental to the actualisation of the Vision. The core of them is associated with good governance while funding is also critical. Meanwhile, through the Transformation Agenda, the present Administration has drafted strategies to combat some of the envisaged emerging challenges in the course of implementing the 1st NIP and ultimately the NV20:2020. Also, the reforms required to creating enabling environment for mobilising the needed resources for NV20:2020 are clearly mapped out.

What more? It is now time for the Administration and all other stakeholders to commit themselves to the transformation of the Nigerian economy. It is also time for the relevant stakeholders to be allowed to take ownership of the strategy for the sake of synergy and appropriate linkages of the various sectors of the economy.

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Financing the Real Sector for Sustainable Economic Growth in Nigeria: Performance, Challenges and Prospects

*O.B. Obembe, Ph.D**

I. Introduction

The role of finance in economic growth has received attention from economists and policy makers in recent time. In the literature, two opposing views however, have been expressed on the role of finance in promoting economic growth. In the writings of the pioneers of development economics, the role of finance was conspicuously dismissed, it was argued that finance does not cause growth but merely responds to changing demand from the real sector. These economists include, Meier and Seers (1984), Lucas (1988), Robinson (1952) and Miller (1988). At the other end, some economists believe that finance indeed causes growth. According to these economists, the understanding of growth will be severely limited without acknowledging the role of finance (Bagehot, 1873; Schumpeter, 1912; Gurley and Shaw, 1955; Goldsmith, 1969; and McKinnon, 1973).

Most importantly, finance performs certain roles in the process of economic growth. These include: mobilising savings (for which the outlets would otherwise be much more limited); allocating capital (notably to finance productive investment); monitoring managers (so that the funds allocated will be spent as envisaged); transforming risk (reducing it through aggregation and enabling it to be carried by those who are more willing to bear it). While a great attention has focused on mobilising savings and allocating capital, the other functions of monitoring managers and transformation of risks have been found to be more crucial in that it is through these functions that the financial sector has usually been referred to as the brain of the economy (Gerard and Patrick, 2001).

The monitoring function is deemed to be very crucial in that the modern system of business organisation that is based on separation of ownership and control was made possible by this monitoring role, which is termed delegated monitor

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(Diamond, 1984). As monitors, they do not only collect information and make loans to firms, but they also track activities of firms and exert corporate control. In this process, they enforce covenants on existing contracts; withdraw financing or even may not renew when firms err financing. This ensures that managers of firms pursue actions that are in the long-term interest of the firms.

Moreover, the financial system can mitigate risks in the process of economic activities. When a firm is provided with access to liquid capital, this could induce the entrepreneurs to taking on highly risky projects with higher returns. More so, when an investor is sure of opting out of an investment without diminishing the value of his investment at any time, this could encourage him to provide finance for projects.

Three broad areas have been identified where finance can contribute to economic growth. (i) Finance can contribute to long-term average economic growth; (ii) it can contribute to the reduction in poverty; and (iii) it can help in the stabilisation of economic activities and income. In all of these roles, incontrovertible evidence provides positive support for the role of formal financial institutions (Gerard and Patrick 2001). Evidence in support of finance on economic growth was provided by Levine, Loayza and Beck 2000). They tried to verify whether finance causes growth and vice versa. Their result did not only support the finance-growth nexus, but also established a positive correlation between financial development and long-run economic growth. Also, the growth effect of financial development was linked to the poverty reduction effect in the economy. Finally, financial development was found to reduce aggregate volatility. Easterly et al (2001) documented that doubling of private credit from 20.0 per cent of GDP to 40.0 per cent was predicted to reduce standard deviation of growth from 4.0 to 3.0 per cent.

In many developing countries, especially Nigeria, a great deal of effort has been concentrated on boosting finance for economic activities. There has been sweeping financial reforms to ensure continuous access to credits by the private sector, however, the Nigerian economy continues to be driven by factor accumulation which has led to unsustainable growth. In this paper, an attempt is made to examine how finance contributes to growth and try to uncover those challenges that have bedevilled the role of finance in the process of economic growth in Nigeria.

Following the introduction, the remaining part of this paper is divided into six sections. Section 2 provides clarification of the basic concept, while Section 3 reviews the theoretical linkages between finance and economic growth. Section 4 provides a brief review of the performance of the financial sector of the Nigerian economy, while Section 5 presents an overview of the performance of the real sector. Section 6 discusses some of the challenges and prospects of financing the real sector in Nigeria while Section 7 concludes.

II. Conceptual Framework

(i) Sustainable Economic Growth

The concept of growth in economics is used to mean an increase in output over time and measured by Gross Domestic Product (GDP). In the growth literature, the classical explanation of growth attributed increase in output to factor accumulation, especially capital. In that analysis, technology was assumed to be exogenous; hence, countries willing to pursue growth were advised to accumulate as much physical capital as possible. However, following the works of the neo-classical economists pioneered by Solow (1956), economic growth was modeled to be influenced by other factors apart from land, labour and capital. In their model, technology was not assumed to be exogenous; hence, countries willing to pursue growth were advised to invest in technology.

The World Development Report (1998), which focused on the role of knowledge in development, clearly highlighted the role of technology. The report compared growth performance of the Soviet Union between 1960 and 1980 that invested heavily in capital accumulation and training of their population with those of the four East Asian Tigers. It was found out that the Soviets generated far smaller increases in living standards during that period than the four East Asian countries. It was observed that these countries may have probably grown smarter than the Soviets during the review period.

The implication arising from neo-classical model of growth is that, growth that is driven by increasing factor inputs of land, labour and capital are subject to diminishing returns, and hence, to stimulate a long-run sustainable growth, there is a need to invest in technology, thereby limiting the emphasis on growth of factor inputs.

In this paper, therefore, sustainable growth is viewed in terms of generating growth that is not subject to diminishing returns in the medium to long-term. In the context of Nigeria, this growth would imply a production system that is based on application of science and technology leading to exports of manufactured goods and diversification of the economy away from oil, which is the chief source of revenue earnings to manufacturing and processing of commodities both for domestic consumption and exports.

(ii) Real Sector

The Nigerian economy has been classified into four major groups for statistical reporting. This classification includes; Production, General Commerce, Services and others. The production sector includes agriculture, manufacturing, mining and quarrying, real estate and construction. The general services include bills discounted, domestic trade and external trade. The services sector comprises, public utilities, transport and communications, while the fourth group classified as others comprises credit and financial institutions, governments, and miscellaneous, which include personal and professional services.

In this paper, the real sector is viewed as the productive sector of the economy comprising agriculture, manufacturing, mining and quarrying, and real estate and construction. However, the discussion will majorly be directed at the agricultural and the manufacturing sectors being the most crucial for sustainable economic growth and development in Nigeria.

III. Theoretical Review on Finance and Growth

This section is based on the work of Levine (2004). The role of a good financial system was classified under five functions in the process of stimulating resource allocation, innovation and growth. These functions include: provision of information ex-ante about investments and allocation of capital; monitoring investments and exerting corporate governance after provision of finance; facilitating trading, diversification and management of risk; mobilization and pooling of savings; and easing the exchange of goods and services.

III.1 Provision of Information and Allocation of Capital

The financial system promotes sustainable growth by providing information on firms, managers and market conditions thereby facilitating resource allocation. It was argued that financial resources (savings) will not flow from individual savers to areas in the economy in which they are mostly needed due to lack of reliable information and hence the enormous cost required for processing information about individual investors which is beyond the capability of individual savers. As a matter of fact, while many models assumed that capital will flow toward the most profitable firms in the economy, this presupposes that investors have good information about firms, managers and market conditions (Bagehot, 1873, p.53). The need to provide information about firms, managers and market to reduce information costs and improve resource allocation has led to the emergence of financial intermediaries, which specializes in the costly process of researching investment possibilities for others. In Boyd and Prescott (1986), financial intermediaries function like banks, in that they accept deposits from the public and also make loans to same. Also, another form of financial intermediary simply specializes in producing information on firms and sells the information to savers without having to mobilise savings and making the savings available to investors (Allen, 1990; Bhattacharya and Pfeiderer, 1985; Ramakrishnan and Thakor, 1984).

Financial intermediaries facilitate economic growth by strengthening the screening of entrepreneurs seeking finance for their businesses. Assuming that many entrepreneurs are seeking finance whose availability is very limited, the onus lies on the financial intermediaries to assess the viabilities of the various investment projects presented by the entrepreneurs and decide to fund the most promising projects thereby inducing an efficient allocation of capital (Greenwood and Jovanovic, 1990). Moreover, financial intermediaries can help in boosting the rate of technological innovation by identifying entrepreneurs with the best chances of successfully initiating new goods and production processes (King and Levine, 1993: Galetovic, 1996; Blackburn and Hung, 1998; Morales, 2003; Acemoglu, Aghion, and Zilibotti 2003). The function of financial intermediary is at the core of Joseph Schumpeter's (1912, p.74) view of finance in the process of economic development: *The banker, therefore, is not a so much primarily a middleman…He authorises people in the name of society…(to innovate).*

Furthermore, the stock market can also encourage the production of information about firms in the market thereby enabling a more efficient allocation of resources. It was argued that as market becomes larger and more liquid, certain categories of individuals may be motivated to invest their resources in producing information about firms in the market for the purpose of trading the information and profiting from it (Grossman and Stiglitz, 1980; Kyle, 1984; and Holmstrom and Tirole, 1993).

III.2 Monitoring Firms and Exerting Corporate Governance

The standard agency theory defines corporate governance problem in terms of how equity and debt holders influence managers to act in the best interests of the providers of the capital (e.g., Coase, 1937; Jensen and Meckling, 1976; Fama and Jesen, 1983a,b; Myers and Majlus, 1984). The strength of the efficiency of the corporate governance system in any economy is presumed to have far reaching implications on sustainable economic growth. They posited that if the shareholders and the creditors were able to provide effective monitoring and influence the managers in taking decisions that maximize firm value, resources will be seen as been well allocated by investors and hence will encourage savers to provide more and enough resources to finance production and innovation plans of the firms. It was also assumed that the absence of an effective corporate governance system could impede resources from flowing to profitable and viable investments (Stiglitz and Weiss, 1983).

Corporate governance may, however, be ineffective in monitoring and influencing the decisions of the management towards the maximisation of the firm value. For instance, small and diffuse shareholders may be handicapped at monitoring the managers because: large information asymmetries typically exist between managers and small shareholders and managers have enormous discretion over the flow of information; they frequently lack the expertise and incentives to monitor the managers due to enormous costs involved in such process; the board of directors elected to represent the shareholders may be bought over by the managers thereby relinquishing their responsibility of protecting the minority shareholders; and the legal codes in several countries does not adequately protect the rights of small shareholders while the legal system does not enforce the legal codes on the books concerning diffuse shareholder rights. All these eventually go to weaken the capacity of the small and diffuse shareholders in providing an effective monitoring on the activities of the managers with adverse consequences on resource allocation and economic growth.

Moreover, concentrated ownership, which emerged in response to the problems confronting the small and diffuse shareholders in performing an effective monitoring function on the managers, can also constitute a great hindrance to resource allocation and economic growth. One major problem identified with concentrated ownership is the issue of conflict arising between controlling shareholder and minority shareholders (Jensen and Meckling, 1976). It is argued that controlling shareholders are usually guilty of expropriation of minority shareholders. Controlling shareholders could expropriate resources from the firm, provide jobs, perquisites and generous business deals to related parties in a manner that hurts firms and society but benefits the controlling owner. Hence, it is assumed that concentrated ownership can distort corporate decisions and national policies in ways that curtail innovation, encourage rent-seeking, and hinder economic growth.

Some literature has pointed out that certain financial arrangements could help mitigate the problems of corporate governance. First, an efficient and a well-functioning stock market is viewed as providing information about the managerial performance that is reflected in the stock price of the firms. This information enables the owners to link compensation of the managers to stock prices, which help in aligning the interest of the shareholders and the managers. (Diamond and Verrecchia, 1982; and Jensen and Murphy, 1990). Furthermore, in a well-functioning stock market, the threat of takeovers by corporate raiders forces the managers to pursue policies that are in the long-term interest of the firms thus, helping in aligning the interest of shareholders with those of managers (Scharfsten, 1988; and Stein, 1988). Finally, some authors have recognised the role of debt contracts in aligning the managerial and shareholders' interests. They argued that shareholders can get the managers committed to obligatory debt payments which limit the free cash flow available to the managers (Aghion, Dewatripont, and Rey, 1999). When a manager has access to enormous free cash flow and there are no viable alternative projects to invest in, the managers can invest in projects with negative Net Present Value (NPV) to boost their managerial utility. A debt contract hence reduces the free cash flow, managerial slack and accelerates the rate at which managers adopt new technologies.

A good financial system, through its intermediaries, can improve the functioning of the corporate governance system. First, financial intermediary can perform the role of a delegated monitor whereby the intermediary mobilises savings of many individuals and makes them available to firms. This process, thus, economises on monitoring costs and eliminates free rider problem (Diamond, 1984). Second, information costs about firms could greatly be reduced, arising from long-run close relationship between financial intermediaries and firms. Furthermore, an efficient financial system could influence growth by boosting corporate governance. The reduction in costs brought about by the intermediaries is viewed to aid effective credit rationing thereby, boosting productivity, capital accumulation and growth (Bencivenga and Smith, 1993).

Furthermore, financial intermediaries are believed to boost innovative activities by undertaking the particularly costly process of monitoring innovative activities, which improves credit allocation among competing technology producers, with positive spillovers on economic growth (De La Fuente and Marin (1996). More so, differences in quality of financial intermediation across countries of the world are viewed as having a great influence on international capital flows (Boyd and Prescott, 1986). Capital is viewed to be mobile and can move from a capital-deficit economy to a capital-abundant economy if the financial intermediary in the capital surplus economy possesses superior capability in fostering efficient corporate governance.

III.3 Risk Amelioration

The existence of information and transactions costs may give rise to financial contracts, markets and intermediaries that facilitate trading, hedging, and pooling of risks, which consequently influence resource allocation and economic growth. Three types of risks have been identified: cross sectional risk diversification, inter-temporal risk sharing and liquidity risk.

Cross sectional risk diversification can be facilitated by banks, mutual funds and security markets by providing a diversified portfolio of risky investments. High-return projects are generally riskier than low-return projects, hence, savers or investors who are generally risk averse will prefer to invest in low-return, low risk projects. Hence, financial markets that make it easier for people to diversify risk tend to induce a portfolio shift towards projects with higher expected returns (Gurley and Shaw, 1955: Patrick, 1966: Greenwood and Jovanovic, 1990; Saint-Paul 1992; Devereux and Smith, 1994; and Obstfeld, 1994). Also, a good and efficient financial system, which enables people to hold a diversified portfolio of risky projects, will foster growth. Without this, agents would avoid high-return and risky projects with the attendant repercussions on growth (Acemoglu and Zilibotti, 1997).

Financial systems also function to ameliorate risks by spreading risks, especially those arising from macroeconomic shocks across generations. This theory focuses on the advantages of intermediaries in easing inter-temporal risk smoothening (Allen and Gale, 1997). Long-lived intermediaries emerge with long-term investment projects thereby facilitating risk sharing across generations. The intermediaries are said to offer high returns in periods of economic downturn and offering low returns in periods of economic boom.

The third type of risk—liquidity—arises as a result of uncertainties associated with converting financial assets into cash or medium of exchange. For the purpose of economic growth, certain long-term projects, which require continuous capital commitment, are required in the economy. Given that investors or savers are not willing to relinquish control of their savings for such long periods of time, the financial system thus, evolves a system through which the continuous capital commitments required by long-term projects is reconciled with the objective of savers who may not be willing to part with their savings for long period of time. Beneivenga, Smith and Starr (1995) explained that high-return, long gestation production technologies require that ownership be transferred throughout the life of the production process in secondary security markets. However, a costly exchange system will make long-run production technologies less attractive, which affects production decisions. Greater liquidity is hence believed to induce a shift to longer-gestation and higher return technologies.

Furthermore, the ability of the financial system to provide funds to ease adjustment costs of financing long-run growth-enhancing projects would lead to sustained economic growth. Aghion *et al,* (2004) provided a model in which firms can either invest in short-term, low return investments or in more risky, growth-enhancing research and development. They also assume that there is an adjustment costs involved in financing innovative projects, especially in periods of macroeconomic shocks. It is believed that under-developed financial systems that are less able to provide firms with funds to ease these adjustments will hinder innovation. Also, macroeconomic volatility exerts negative impact on innovation and growth in underdeveloped financial system because firms' willingness to undertake research and development depends on their ability to borrow in the future to meet adjustment costs, which is influenced negatively by the likelihood of experiencing a recession and positively by the level of financial development.

III.4 Pooling of Savings

The processes of mobilising savings involve overcoming two important costs: transaction costs associated with collecting information from various individuals; and information costs bothering on the integrity of the financial institution collecting the funds. In an attempt to mitigate the effect of these costs, two major financial arrangements are usually put in place. These include multiple bilateral contract between productive units raising capital and agents with surplus resources as well as financial intermediaries that pool the resources from several savers and invest the savings in several companies (Sirri and Tufano 1995). Pooling of savings is said to help economic growth and development in the following ways: increasing the level of savings in the economy; exploiting economies of scale; overcoming investment indivisibilities; improvement in resource allocation; and boosting technological innovation.

Without access to multiple investors, many production processes would operate at a sub-optimal scale of production (Sirri and Tufano, 1995). Furthermore, there are several investment projects whose capital requirements are beyond the capabilities of single individuals (Bagehot, 1873). More so, financial intermediaries create financial instruments in small denominations, which enable households to hold diversified portfolio of assets (Sirri and Tufano, 1995). Acemoglu and Zilibotti (1997) showed that with large, indivisible projects, financial arrangements that mobilise savings from diverse individuals and invest in a diversified portfolio of risky projects facilitate a reallocation of investment toward higher return activities with positive ramifications on economic growth.

III.5 Easing Exchange

Financial arrangements that lower transaction costs can promote specialisation, technological innovation and growth. Greenwood and Smith (1996) explained that more specialisation in the economy gave rise to more transactions that would lead to increase in costs, financial innovation which lowers the costs of transactions and eventually promote productivity gains.

IV. Overview of the Nigeria Financial System

The Nigeria financial system consists of the regulatory agencies such as the Central Bank of Nigeria (CBN) and Nigerian Deposit Insurance Corporation (NDIC) for the banking sector, while the Security and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) oversee the capital market.

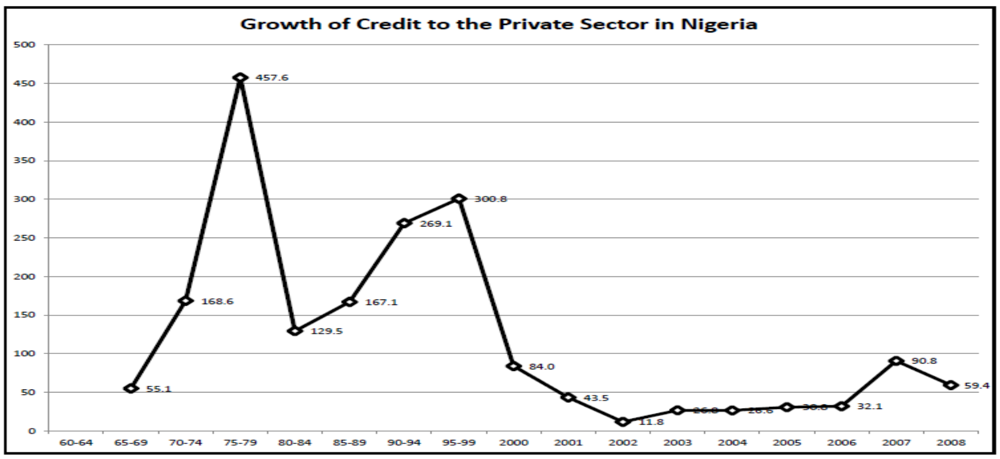
IV.1 The Banking System

The banking system consists of institutions that deal in short-to-medium-term loans and advances, which includes the commercial banks and the specialised development banks. The Nigeria banking industry, all through the 1970s and better part of 1980s was dominated mainly by three big banks — the First bank, the Union Bank and the United Bank for Africa (UBA). This situation persisted until the liberalisation of the financial system in 1986, which opened up the sector for more participants. After deregulation, the number of banks increased to over 100, however, most of these banks were characterised by weak capitalisation and management. In July 2004, government came up with a new plan to strengthen the banking industry. The capital base was increased to ₦25 billion and banks were encouraged to consolidate their assets through mergers and acquisitions. The aftermath of this exercise left the Nigerian economy with 25 banks, compared with 89 banks in 2003. The assets of Nigeria's deposit money banks represent about 90.0 per cent of the total assets of Nigerian financial system and also accounted for about 70.0 per cent of the total credit extended to the private sector (King, 2003).

Apart from deposit money banks, there were some other institutions that function as non-bank financial intermediaries in the banking industry. These included finance companies, mortgage finance institutions and development financial institutions. The finance companies have shown very little signs of growth in Nigeria and have not achieved any significant impact on the economy. The development finance institutions (DFIs) have been the major channel for government's financing of the real sector in Nigeria. These institutions include: the Nigeria Agricultural, Cooperative and Rural Development Bank (NACRDB) now Bank of Agriculture; the Nigerian Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industry (NBCI) now merged to become the Bank of Industry (BOI), are part of the DFIs. The development banks did not really have a good history of development in Nigeria. They are characterised by weak management, excessive operating costs, politicised lending and enormous loan losses (King, 2003). As at the end of the 1990s, more banks had become technically insolvent because their asset-base had totally or partially been eroded.

The financing of the real sector in Nigeria by the banking system can be much appreciated by examining the growth trend of banking system credit to the private sector. This is presented in Figure 1. The values were presented as averages from 1960 to 1999, and presented as actual growth from 2000 to 2008.

Figure 1: Growth of Credit to the Private Sector in Nigeria (Per cent).



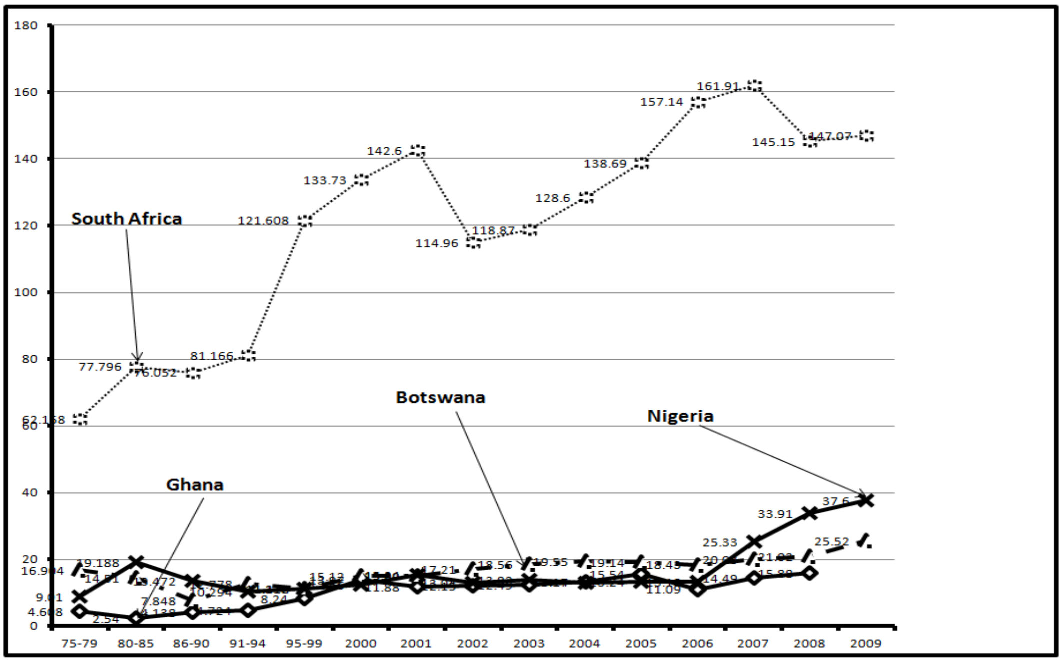
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

From Figure 1, it can be gleaned that credit to the private sector grew very significantly between 1965 and 1979 before falling significantly in the late 70's and early 80's. However, credit to the sector eased from 1984 to 1999. Incidentally, the period of a fall in growth coincided with the period of civil rule, while the period of credit growth corresponded with the period of military intervention. The period of credit growth to the private sector reached the peak from 1995 to 1999. Nonetheless, from 1999 to date when government returned to civil rule, credit to the private sector growth has been very sluggish except in 2007. This indicated a downward trend in the growth of credit to private sector making it less attractive for bank financing.

Financial Deepening in Selected African Countries

The trend of percentage of finance to the real GDP in Nigeria and some selected African countries is presented in Figure 2. The figure shows that Nigeria's financial deepening never exceeded 20 per cent of the GDP until around 2006 when it began to experience an increasing trend.

Figure 2: Financial Deepening of Selected African Countries (Per cent)



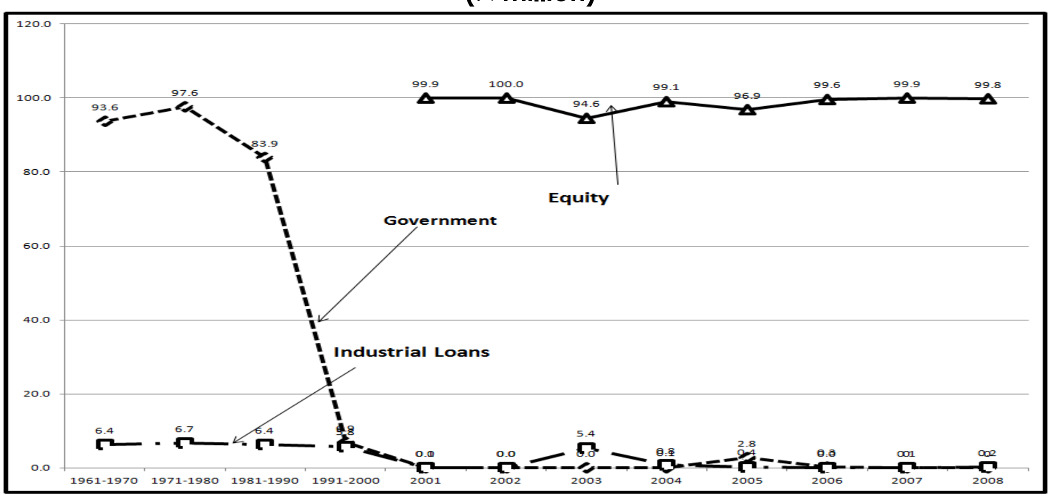
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition and World Bank Staff estimates from the Comtrade database maintained by the United Nations Statistics Division.

When compared the performance of Nigeria with other countries in the continent, Botswana was found to perform better until 2006 when Nigeria experienced some level of growth. However, Botswana's performance has been on the increasing trend although not up to 20.0 per cent till the middle of 2006 and 2009. The highest growth recorded for Botswana was 25.52 per cent. Ghana's performance has also been increasing steadily although not at the same pace with Nigeria. The story became different when Nigeria's performance was compared with that of South Africa. The impression emanating from the figure shows that it will take a longer time for Nigeria to reach the starting point of South Africa in 1970-1975, which is put at 62.1 per cent. South Africa has continually witnessed an increasing growth in financial deepening, which in 2007 reached a performance level of 161.91 per cent of GDP before moderating to 145.5 per cent in 2008. Indeed, Nigeria will need to learn a great lesson from South Africa to boost its financing of economic activities.

IV.2 The Nigerian Capital Market

The capital market comprises the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE). It is a market for long-term funds whose performance could have a bearing on the performance of the real sector of the economy. Figure 3 provides a picture of the transactions in the market between 1961 and 2008.

Figure 3: Transactions in the Nigerian Stock Exchange between 1960-2008 (₦'million)



Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

The figure clearly shows that between 1961 and 1990, government stocks were the most actively traded in the market before nose-diving to less than 10 per cent of total stock traded in 2001. The proportion of industrial loans traded has been very insignificant all through the review period. It averaged about 6.0 per cent from 1961 to 2009, but fell significantly to zero per cent in 2001 and 2002. It recorded the highest of 5.4 per cent in 2003. The equity sector was the most actively traded shares in the market.

V. Performance Appraisal of the Real Sector of the Nigerian Economy

The structure of the Nigerian economy can be classified into four categories. These include the production sector, general commerce, services and others. The production sector, which is also referred to as the real sector, comprises agriculture, manufacturing, mining/quarrying and real estate/construction. General commerce comprises bills discounted, domestic trade, exports and imports. The services sector includes public utilities, transport and communications. The final category comprises credit and financial institutions, governments, and miscellaneous.

The appraisal is focused on the real sector performance. The performance of the real sector is very essential for the long-run growth and development of the country and efforts have been made by successive governments in Nigeria to develop the sector.

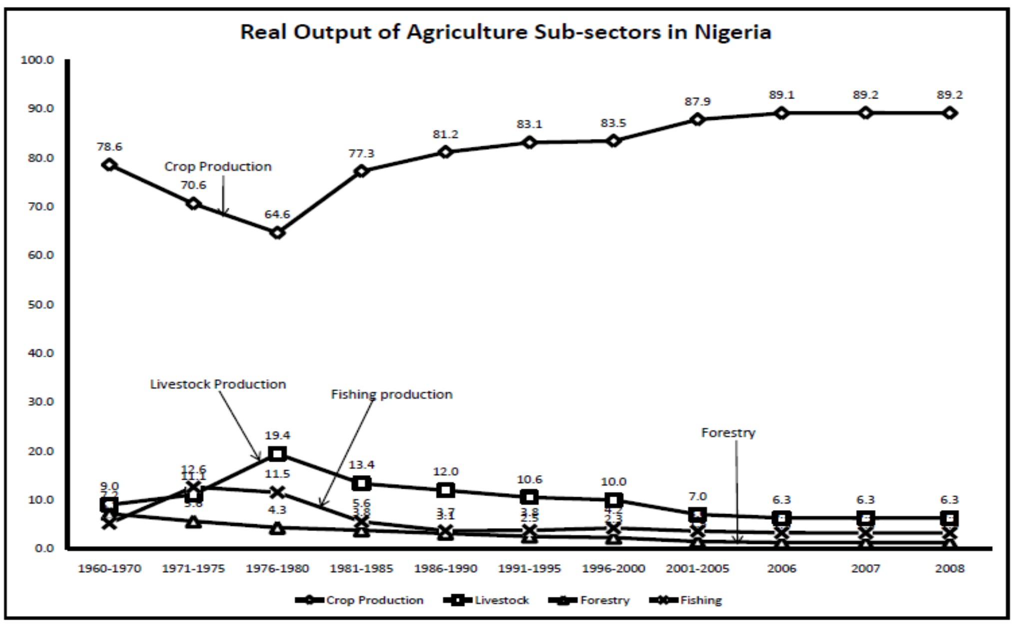
V.1 Performance of the Agricultural Sector

Nigeria is generously endowed with favourable conditions for sustainable agricultural development. First, the country is blessed with different climatic and vegetational zones, which make it suitable to the cultivation of various agricultural crops. Furthermore, the country has a large expanse of land that is suitable for both crop production and animal husbandry. It is estimated that the country possesses about 91.07 million hectares of land of which about 77.0 per cent of it is cultivable while 44.0 per cent of the cultivable land were actually under cultivation. The remaining 30.8 hectares were under arable and permanent crops. Several inland rivers and extensive ocean coast also exist for profitable fishing activities both for local consumption and exports.

The production system comprises small scale farmers (cultivating 0.1-5.99 ha), medium scale farmers (cultivating 6-9.99 ha) and large scale farmers (cultivating more than 10 ha and above). It is estimated that the small scale farmers account for 81.0 per cent of producers, while they produce about 95.0 per cent of agricultural output in Nigeria (Shaib et al, 1997). The production system is expected to be dominated by the small scale farmers for the next 25 years. The average age of the farmers are high and increasing which implies that young and dynamic entrepreneurs are not attracted to agriculture.

The agricultural sector is divided into four sub-categories. These include; crop production, animal rearing, fishing and forestry. Under the crop production category, crops cultivated include roots and tubers, cereals, tree crops (oil palm and cocoa), fiber and fruit crops. In terms of cultivation, cereals predominate as 20,000 ha of land were cultivated followed by the roots and tubers crop with about 8,000 ha and 4,000 for tree crops. Fruit crops and fibre were cultivated on 2,000 ha and 1,000 ha, respectively. The major crops cultivated include sorghum, millet, cowpea, maize cassava, rice and cocoyam. Analysis of sub-sectoral real outputs showed that the crop production sub-sector was the most significant. This is shown in the Figure 4.

Figure 4: Output growth of Agriculture Sub-sectors of Nigeria (Per cent)



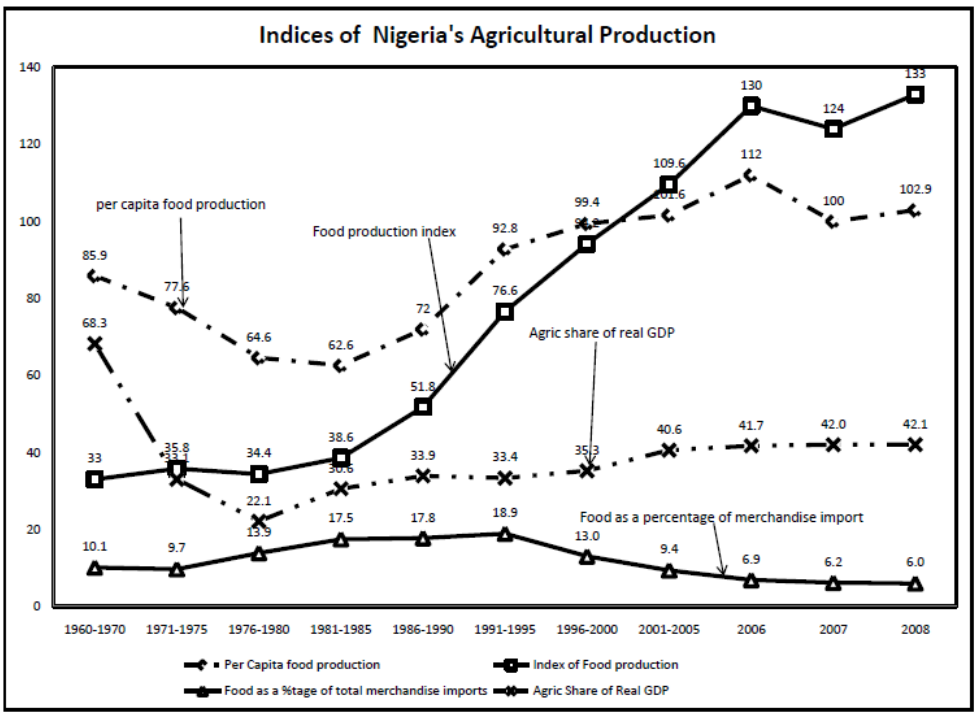
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

The figure presents the trend performance of the sub-categories in the agricultural sector from 1960 to 2008. The crop production sector shows that average real output fell from 78.6 per cent from 1960 to 1970 to its minimum of 64.6 per cent from 1976 to1980. However, average real output has since steadily been on the increase to 77.3 per cent from 1981to1985 until 2008 when it rose to

89.2 per cent, which is higher than the average recorded from 1960 to 1970. Following the crop production category was the livestock production sector. Average real output rose from 9.0 per cent from 1960 to 1970 to its highest of 19.4 per cent from 1976 to 1980, and it has declined consistently thereafter, until 2006 to 2008 when it stagnated at 6.3 per cent. The fishing and forestry sector contributed less than 10.0 per cent all through the review period, except for fishing that contributed an average of 11.5 per cent between 1976 and 1980.

An appraisal of the performance of agricultural sector is further presented in Figure 5. Four indices of performance were adopted in appraising the sector. These include: agric share of the real GDP; Index of food production; per capita food production; and food import as a percentage of total merchandise import.

Figure 5: Indices of Agricultural Production



Source: CBN Statistical Bulletin 50 years Special Anniversary Edition

Figure 5 showed that agricultural sector played a very prominent and significant role in the economic growth of Nigeria from 1960 to 1970, as the sector contributed an average of 68.3 per cent of the real GDP. However, this contribution declined to an average of 22.1 per cent from 1976 to 1980 before picking up gradually until 2008. The contribution of agriculture to GDP is still buoyant considering the role played by crude oil in Nigeria since the 1970s. Considering the structure of agricultural production dominated by small scale cash-crops producing rural dwellers, the agricultural sector is still grossly unproductive and unsustainable.

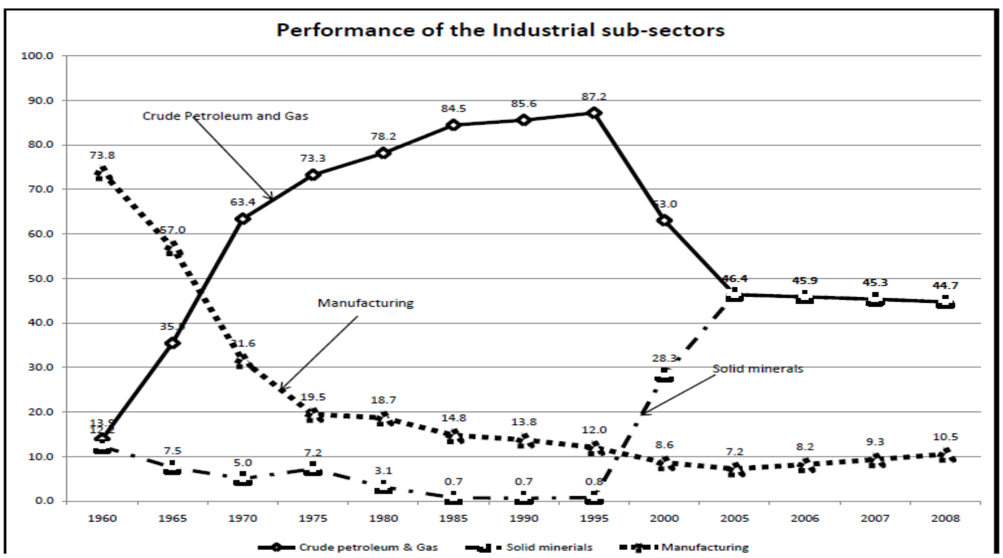
The food production index assumed an upward trend throughout the review period. It rose from an average of 33 points for the period 1960 to 1970, to 51.8 points from 1986 to 1990 and further to 130 and 133 points in 2006 and 2008, respectively. The rise in index of food production was attributed to increase in the area of land cultivated and number of people engaged in the production process. A sustainable and productive agricultural sector will require extensive application of science and technology with limited proportion of people engaged in the sector. The weakness of this increase in food production index could, however, be seen in the per capita food index, which consistently declined from an average of 85.9 points from 1960 to 1970 to an average of 62.6 points from 1981 to 1985. The index, thereafter, took an upward movement, but its rate of growth has been very sluggish and could not compare with the rate of food production. The per capita food production index eventually assumed a decline in 2006. The implication of this is that the rate of food production is definitely not at pace with the rate of population growth.

Nigeria has continually spent a huge sum of her foreign exchange earnings on importing food to meet the domestic short falls over the years. From 1960 to 1970, the country spent an average of 10.1 per cent of import on food importation, while it fell to 9.7 per cent from 1971 to 1975. The rate increased thereafter, until it reached an average of 18.9 per cent from 1991 to 1995, when it began to decline steadily to 6.0 per cent in 2008.

V.2 Performance of the Industrial Sector

The industrial sector is categorised by the National Bureau of Statistics (NBS) into three sectors. These categories include crude petroleum and natural gas, solid minerals and manufacturing. Nigeria is blessed with abundant crude oil and natural gas. Official estimates put Nigeria's crude oil reserves at 34 billion barrels and it is expected to increase to about 40 billion barrels. Also, Nigeria is blessed with natural gas, which is estimated to be about 159 trillion cubic feet, which ranks it as one of the ten largest gas endowed countries in the world. Apart from crude oil and natural gas, Nigeria is blessed with several solid minerals, among which are limestone, tin, columbite, kaolin, gold and silver, coal, led, zinc, gypsum, clay, shale, marble, graphite, iron-ore, stone, among others. Most of these minerals are not yet fully tapped due to the dominance of crude oil in the Nigerian economy. These resources provide Nigeria with ample opportunities of becoming an industrial giant not only in Africa, but also in the world. Figure 6 presents a picture of the activities in the industrial sector of the Nigerian economy.

Figure 6: Performance of Industrial sub-sectors of Nigerian economy

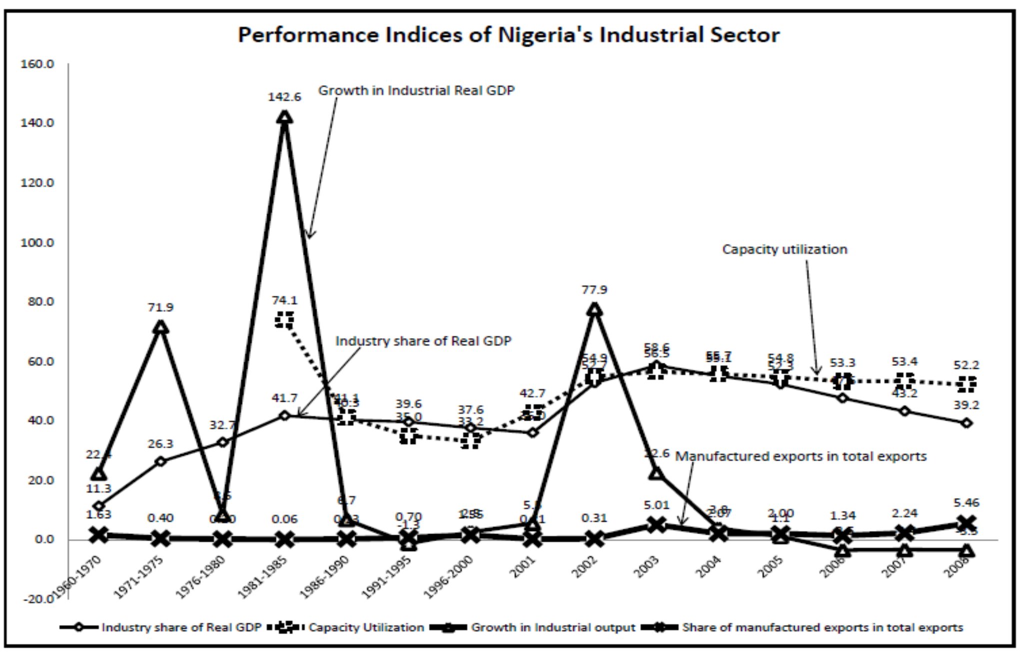


Source: The CBN Statistical Bulletin 50 years Special Anniversary Edition.

From the figure presented, it is very clear that there has been an inverse relationship between the growth of the crude oil and gas on one hand, and the growth of the manufacturing on the other. It is disheartening to observe that in 1960, the manufacturing sector which contributed about 73.8 per cent of the industrial real GDP was only able to contribute 7.2 and 10.5 per cents in 2005 and 2008, respectively. It is very clear that crude oil production in Nigeria led to the suppression of the manufacturing activities. The sector grew from 13.9 per cent in 1960 to 63.4 per cent in 1970 before reaching a peak of 87.2 per cent in 1995 and assumed a steady decline from then till 2005. The solid minerals sector was very much inactive until 1995 before it began to play some roles in the industrial sector. Its contribution rose from 0.8 per cent in 1995 to 28.3 per cent in 2000 and the highest of 46.4 per cent in 2005 and grew at the same rate thereafter with the crude oil production.

The manufacturing sub-sector has occupied the attention of government for several years in Nigeria and there has been a deliberate policy to stimulate the growth of the sector. For instance, the Bank of Industry was established by government to finance the industrial sector in addition to the credit guidelines issued to the deposit money banks (DMBs) to set aside certain percentage of their loans to the industrial sector, especially the small and medium scale enterprises (SMEs). The overview of the performance of the manufacturing sector is hereby explored.

Figure 7: Performance Indices of Nigeria's Industrial Sector



Source: The CBN Statistical Bulletin 50 years Special Anniversary Edition.

The indices of performance are as indicated in the graph. The growth in industrial GDP has been highly volatile. The average growth of the industrial real GDP rose from 22.4 per cent in the 1960s to an average of 71.9 per cent from 1971 to1975, it again nose-dived to an average of 8.5 per cent from 1976 to 1980. The sector experienced another sharp growth from 1981 to 1985 when the highest growth of 142.6 per cent over the previous period was recorded, while all through the 1990s to 2000, the sector almost got paralysed. Incidentally, this period coincided with political upheavals in Nigeria. The sector began to pick up again in 2000 and beyond.

The industrial share of the real GDP also has not been too impressive. It grew from 1.6 per cent in 1960s to 41.7 per cent for the period 1981 to 1985. As a matter of fact, the growth experienced in the manufacturing sector declined to 36.0 per cent in the period, 1996 to 2000. The trend of growth since 2001 has been downwards. The rate of capacity utilisation has also followed a similar trend with its share of real GDP. Capacity utilisation fell from 74.1 per cent from 1981 to 1985 and 33.2 per cent from 1996 to 2000. The rate has since gradually climbed to its highest of 56.5 per cent in 2003.

Available statistics showed that the Nigerian manufacturing sector is grossly uncompetitive. The dismal performance of manufacturing can be attributed to the hostile environment of operation. Manufacturing is very expensive in Nigeria due to inadequate electricity and other poor infrastructure; hence the output of the sector has not been competitive in the global market.

VI. Challenges of Financing the Real Sector in Nigeria

VI.1 Weak Property Rights Protection

One of the major challenges of financing the real sector in Nigeria lies in the weak protection of property rights. The Heritage Foundation computed data on economic freedom index and incorporates property rights protection as one of its indices. It was pointed out that the ability of the government to protect people's rights goes a long way to stimulating sustainable growth. In this regard, the independence, transparency and effectiveness of the judicial system were viewed as the key determinants of a country's prospects for growth. In fact, it was asserted that capital accumulated over long period of time will help to stimulate growth, if there was effective protection of property right (EFI, 2002).

Countries were classified into one of the five categories: Free, mostly free, moderately free, mostly un-free and repressed. Unfortunately Nigeria's record of performance among other countries of the world has been very poor. Nigeria's score has consistently put it in the group of repressed nations. The report pointed out that Nigeria's judiciary suffers from corruption, delays, insufficient funding, lack of court facilities, a lack of computerised systems for document processing, and unscheduled adjournments of court sessions due to power outages. Out of 179 countries listed in the 2011 report, Nigeria was ranked 111th position. Other African countries ranked included; Ghana 95, South Africa 74, Egypt 96, while United Kingdom was ranked 16.

The implication of the weak property right protection on financing the real sector in Nigeria is that banks usually finds it difficult to give out loans to prospective applicants due to the problem envisaged in enforcing loan repayment agreements in case of default. More so, getting acceptable property as collateral security from borrowers can be very difficult since protection is weak.

Another dimension of this problem lies in the area of intellectual property rights protection. The fragile nature of intellectual property rights protection has placed an enormous challenge on banks in financing the real sector in Nigeria. Creative works of science and technology, and also arts require heavy investments which the investor would like to recuperate if the work succeeds. However, the intellectual property rights environment in Nigeria has been very weak and hence constituting a dis-incentive to investment in creative works. A good example is the movie and the music industry in Nigeria. Some analysts believe that if the industry is well protected it could yield income in excess of what is derived from the oil industry, but the rate of piracy of works of arts, counterfeiting of products such as pharmaceuticals in Nigeria has made it difficult for serious investment in the real sector and such development could discourage banks from advancing credit to the sector.

VI.2 Poor Entrepreneurship Development

The entrepreneur is key to the growth and expansion of the capitalist economic system. According to Schumpeter (1943) entrepreneurs are the individuals who adopt inventions. They introduce new products or processes and new or improved management techniques; they open up new markets and new sources of supply.

Nigeria's entrepreneurial class has failed to emerge and this could be attributed to certain factors. First, the indigenous entrepreneurs in the Nigeria's colonial days were eventually turned to mere traders because Britain was not interested in the industrial development of Nigeria. Raw materials were produced in Nigeria and the local businessmen who were supposed to be entrepreneurs became produce buyers for the British, hence the entrepreneurial class was subdued. Secondly, in the early days of independence, in an attempt to gain economic independence, Nigerian government became entrepreneurs and was involved in almost all the economic activities. However, all the efforts made by government at building the economy became largely unsustainable when the price of oil crashed and the state-owned enterprises became a draining pipe for public funds. The advent of the neo-liberal policies propelled the Nigerian government to embark on the Structural Adjustment Programme (SAP) in 1986, thereby ceding ownership of some public enterprises to the private sector. Apart from the banking sector, which became unstable during that period, the real sector was still in the state of comatose. Another reason why Nigeria suffers from dearth of entrepreneurs is the nature of the public sector. The sector is not flexible to changes in the job market. Minimum wage legislations and the rigid wage system make entrepreneurship unattractive.

Poor entrepreneurship development has posed a great challenge in financing the real sector of the Nigerian economy. In spite of the huge funds set aside by the government at various times to finance the SMEs coupled with the huge deposits in the hands of the banks, especially in the wake of the banking consolidation exercise, good business proposals from businessmen in the real sector were, however, not forthcoming. Hence, the banks had no option than to look for outlets that would guarantee safety of their loanable funds. A good number of the banks came out with proposals for those willing to purchase new cars, which were mainly imported into the country. Another challenge faced by banks in this area is that most of the firms (SMEs) applying for loans did not have a good record keeping culture thus, making it difficult for banks in evaluating the viability of such firms as well as their repayment capacities. The cumbersome nature of assessing the viability of firms in the real sector has discouraged banks from financing the real sector, especially the SMEs in Nigeria.

VI.3 Uncompetitiveness of the Real Sector

The real sector of the Nigerian economy is largely uncompetitive, which poses a great challenge to adequate financing of the sector. The World Economic Forum (2007) provided a clue to understanding the competitiveness of a country. In its view, competitiveness was understood to mean a set of factors, policies and institutions that determine the level of productivity of a country. Hence, it observed that raising productivity is the driving force behind the rates of return on investment, which in turn determines aggregate growth rates of the economy. A competitive economy was believed to be the one that will likely grow faster in a medium to long-term perspective. Productivity growth was believed to result from greater openness and stronger links with the world economy, thereby imposing valuable discipline of international competition and attraction of capital and expertise that could enhance the prospects of growth through increased efficiency.

Nigeria's rating in the competitiveness report, among 125 countries assessed, was 101. In other words, Nigeria was 24^{th} most inefficient country in the world. In that same report, other African countries rated included: South Africa, 45; Mauritius, 55 and Botswana, 81. Another way of viewing Nigeria's position is that, enormous resources are been wasted in the process of production in Nigeria. Indeed, most of the reports assessing financing of the real sector in Nigeria have alluded to the fact that agricultural financing has been very discouraging due to the fact that most of the operations or planting have depended on natural rainfall for harvest. More so, the agricultural farming sector has mostly been dominated by peasant farmers who cultivate mainly for subsistence purposes on small acres of land. The implication of this farming method is that the application of mechanisation, coupled with science and technology is constrained, thereby limiting the effectiveness of funds committed to boosting the growth of the sector.

Moreover, the manufacturing sector largely remains uncompetitive, owing to the cost of doing business in Nigeria. The poor state of infrastructure, such as electricity, inefficient transportation and telecommunications, has placed a limit on the extent to which modern technology can be sourced and applied in Nigeria for production processes. Hence, products from the sector are usually more expensive than imported ones. This may have consistently put off the banks from committing funds to the sector because the rate of return eventually may not be worth all the troubles of administering and monitoring the loans.

VI.4 Lack of Competition

The financial sector has been dominated by few big firms. It is reported that a few firms in the industry controls about 51.0 per cent of the asset-base of the banking industry. Moreover, in the capital market, active trading on stocks has been reported to be restricted to some specific sectors or firms. Under this condition, the banks can literally determine financing patterns in the economy. More so, small scale entrepreneurs will not be favoured in loans application, which can further stiffed entrepreneurship development. The problem of lack of competition has been entrenched in the Nigerian economy since independence. The large scale involvement of government in economic activities has limited the extent of competition in the country, more so, in our political affairs, most vital decisions have always been taking on the basis of federal character and quota system. The implication of this is that most of the times, excellence is sacrificed for ethnicity. Without competitive behaviour in the banking industry and the capital market, the culture of creativity and innovation, which is a feature of a capitalist economic system, will continue to elude Nigeria.

VI.5 Poor Corporate Governance System

The issue of corporate governance system has become a source of concern in the recent time. This concern arose from the various financial scandals that have rocked several large corporations in the US and other developed countries in the recent times. Thus, the efficiency of the existing corporate governance structure in protecting the rights of providers of capital has been largely called into question by policy makers and researchers. According to Shleifer and Vishny (1997), corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Corporate governance has been shown to have links with economic development. In a report prepared by Claessens (2001), five of such links were provided. These included: increased access to external financing by firms which in turn can lead to larger investment; higher growth and greater employment; lowering the cost of capital and associated higher valuation; thereby making investment more attractive to investors and hence promoting growth; better operational performance through optimal allocation of resources and efficient management; reduced risk of financial crisis is guaranteed; and better relationship with stakeholders which helps social and labour relations.

From the channels identified above, the first two channels are very key in financing the real sector. Studies have shown that the stronger the creditors' rights are protected, the more they are willing to extend financing to firms (La Porta et al, 1997). Corporate governance system has been a challenge to suppliers of credit in Nigeria. The culture of transparency and accountability has not been well entrenched in Nigeria, owing to prolonged period of military rule, which led to evasion of official procedures in the management of the state businesses. This has resulted in inadequate finance from lenders and where funds were made available; they are usually at high cost thereby constraining the growth of the real sector in Nigeria.

Furthermore, the poor state of corporate governance in Nigeria may have sent negative signals to foreign investors. If foreign investors are able to form an opinion that resources channelled to the firms are not going to be well allocated, it discourages more funds from coming into the system and hence limits the extent of innovation a firm may contemplate embarking upon for further expansion and competitive advantage.

VI.6 The Size of the Public Sector

The size of government in Nigeria has posed serious challenges in financing the real sector. Ordinarily, an increase in government size crowds out private investment. In Nigeria, government has resulted to the banks in financing some of its activities. This places some pressure on the available funds in the economy thereby driving up the interest rates and making cost of investment to private investors, especially in the real sector to be expensive. Banks finds it more profitable and safe to lend money to government than for real investment, over time, finance has tilted in favour of government in meeting its recurrent expenditure which discourages long-term sustainable growth and economic development. Furthermore, this has further limited the extent of competition in the Nigerian banking sector. Borrowing to the government is almost riskless, hence genuine entrepreneurs seeking funds from the banks may find it difficult to access.

VI.7 Inappropriate/Inefficient Government Intervention

Nigerian government in an attempt to stimulate the growth of the real sector and achieve economic independence has consistently intervened in the financing of the real sector. Government, through the Central Bank of Nigeria, has provided loans to the agricultural and the industrial sectors, more so, credit guidelines have been used to direct credits to government's priority sectors. Government also established development banks for agriculture and industrial development.

Government strategy here involved making loans available to farmers and small scale industries at concessionary interest rates far below the market interest rates. However, some beneficiaries of these loans eventually divert the loans to other profitable businesses, since it was at a lower interest rate. Some other beneficiaries are not able to utilise the loans appropriately because of lack of credit discipline and the underlining welfare implications attached to such loans such as poverty alleviation.

In an era of liberalisation, there is the need for government to begin to review its roles in the area of intervention in the financial markets. Government must work to ensure that the markets perform its role while government also should not abdicate its roles of ensuring that necessary infrastructure is provided to drive economic growth.

VI.8 Politicisation of Policy Instruments

The politicisation of government policy programmes has also led to the inefficient financing of the real sector of the economy. Most of the times, politicians make promises to rural farmers on how to release funds to them to expand their agricultural projects in return for their votes. When elections are over, government special financing programme are implemented with political coloration. Loans are secured through party affiliations and loyalties. Hence, the loans were usually not disbursed on the basis of merit. In addition, beneficiaries of the loans believed that the loan was their own share of the national cake which need not be paid back. An appropriate policy instrument for the development of the real sector must be such that once it is formulated, it must be implemented by efficient and capable bureaucrats who are insulated from politics.

VI.9 Lack of Development of Rating Agencies

One of the challenges facing financing of the real sector in Nigeria is the lack of development of the rating agencies. These agencies provide useful information about the stock market thereby providing ratings to the performance of the stocks quoted on the exchange. The lack of development of this institution has placed a heavy limitation on information acquisition about firms in the market.

Lack of information has led to a higher level of asymmetric information, which limits the financing of the sector.

VII. Prospects of Financing the Real Sector in Nigeria

The prospect of making finance enhance sustainable growth in Nigeria rests on some three major issues, among others. These include, upgrading the financial infrastructure to a level that can guarantee effective protection of creditors' rights; stimulating competition to eliminate monopoly practices; and the adoption and intensive use of information technology infrastructure in collecting information about practices in the financial markets.

VII.1 Upgrading Financial Infrastructure

Nigeria would need to adopt the culture of transparency and accountability as obtains in the British financial legal system. Not only that the laws are upgraded and fine-tuned to strengthen creditors' rights, there must be political will on the part of the government to implement such laws. Moreover, Nigeria must begin to respect the doctrine of the rule of law in the conduct of its affairs. The democratic dispensation is a good platform to review and update the laws and make it up-to-date.

VII.2 Promotion of Competition

Nigeria would need to create environment for competition before finance can have any meaningful impact on sustainable growth. The monopoly situation in the banking industry prevents a good number of entrepreneurs from gaining access to finance. Banks in Nigeria gives loans to well established companies and government agencies, thus, denying small businesses of credits. Competition promotes innovation and creativity. It would enable the banks to creatively finance the economy if the competitive pressure is intense. The lack of competition in Nigeria emanates from its policy of quota system and federal character in the conduct of political affairs. These have crept into the economic spheres leading to monopoly behaviours which aggravates rent-seeking behaviour in the economy and limits productivity.

VII.3 Adoption of Information Technology

The risks involved in financing the real sector can greatly be reduced, if Nigeria fully adopts information communication technology in the conduct of its economic affairs. Given that most businesses, especially small scale industries do not keep records, it has become difficult to assess their creditworthiness. However, in the age of information technology, the central bank in conjunction with the state governments and the Small and Medium Enterprises Development Agency (SMEDAN), would need to commence the computerisation of all the firms operating in Nigeria. There might be the need to build standardised accounting software for the submission of all transactions on a monthly basis for monitoring and evaluation. Information generated through this process can greatly reduce information asymmetry and level of risk exposure by banks in financing the real sector.

VIII. Conclusion

This paper examined some of the challenges constraining the financial sector in stimulating sustainable growth in Nigeria. The challenges highlighted in this work includes: poor property right protection; poor corporate governance system; lack of competitiveness of the real sector; lack of competition in the economy; poor entrepreneurship development and lack of development of rating agencies in Nigeria. It observed that for a successful real sector financing in Nigeria, a culture of accountability and transparency in the conduct of our national affairs must be taken seriously. The quality of governance must also be improved, to ensure that the legal framework for economic activities is well strengthened, such that the protection of creditors' rights may not be jeopardised.

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Policy Choices and Challenges in Expanding Access to Finance for Growth in Rural Nigeria

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I. Introduction

Access to finance, in general, is fundamental to growth and development. A well-functioning financial market assists in channeling funds to their most productive uses, and allocates risks to those who can best bear it. An efficient financial sector that responds to the needs of the private sector increases investment, enhances economic growth, creates job opportunities and improves income distribution. Access to financial services in the rural area, in particular, allows poor people to manage their household cash flows, start new agricultural activities and set up small businesses. When poor households have access to higher earnings and well-secured facilities to save their money, they can pay for health care and education, and plan and invest in the future of their farms or businesses.

Based on the available evidence, the Nigerian financial system has witnessed significant developments in terms of growth and depth over the years. The development could be attributed in part to the vast network of financial institutions, including rural finance. In the area of rural finance, for instance, the Government and the Central Bank of Nigeria had to intervene, especially with the stipulation of credit guidelines to favour agriculture and agro-allied activities, which constitutes 70.0 per cent of the activities in the rural areas. Several programmes and schemes were also implemented to enhance increased credit to the rural areas. These include sectoral allocation of credit and concessionary interest to rural and micro entrepreneurs. As an illustration, in 1969, commercial banks in Nigeria were compelled to lend at least a minimum percentage of their loanable funds to the agricultural sector, which increased from 4.0 per cent in 1972 to 18.0 per cent in 1996. Also in 1977, the CBN introduced the rural banking policy that required commercial banks, not only to open stipulated numbers of rural branches, but also, to advance not less than 50 per cent of the total deposit mobilised in the rural areas to rural borrowers. The number of rural branches thus, increased from 13 at the inception of the rural banking scheme in 1977 to 722 in

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2005. Finally, programmes such as the Agricultural Development Programme (ADP), the National Directorate of Employment (NDE), the Directorate of Food, Road and Rural Infrastructure (DFFRI), Better Life for Rural Women, and National Microfinance Policy and Regulatory Framework (NMPRF), were all geared towards access to finance for growth in the rural areas.

Improvements in rural finance, notwithstanding, the supply of formal finance appears to be biased against the rural population. Rural communities remain centre of deprivations inspite of the various efforts aimed at increasing financial services to them by the Government and the CBN. This, therefore, raises the following questions: what are the constraints and challenges of providing financial services in the rural areas? What are the policy initiatives that can be introduced to improve rural financial services in Nigeria? Hence, the main objective of the paper is to examine the challenges and ways to improve rural financial services in Nigeria.

The rest of the paper proceeds as follows. Section 2 discusses some conceptual issues in rural financial policy. Section 3 examines various challenges facing expansion of financial services to the rural areas while Section 4 identifies policy programmes and challenges in expanding access to finance for growth in rural areas. The last Section provides the conclusions.

II. Conceptual Issues in the Provision of Rural Finance Services

II.1 The Concept of Rural Finance

Rural finance refers to the broad range of financial services, such as savings, credit, payment transfers, leasing, insurance, etc, rendered by formal and informal financial service providers operating in rural markets. According to the Consultative Group to Assist the Poor (CGAP), rural finance is the financial services offered and used in rural areas by people of all income levels. It addresses the financial needs of the rural population. It assists in facilitating economic opportunities and plays a critical role in household strategies to reduce vulnerability. Where economic opportunities already exist, access to credit can assist in enhancing greater adoption of improved technology, thereby, increasing the level of productivity and incomes (Wangwe and Lwakatare, 2004).

Basically, the objectives of rural financial systems include, amongst others, promotion of measures to facilitate the access of all categories of rural entrepreneurs (individuals farmers, rural industrialists, cooperatives, e.t.c.) to credit on reasonable terms, and the provision of secured facilities to save money and serve as insurance against risk. Others are promoting the establishment of, and support for the provision of banking and credit institutions, which are particularly responsive to the needs of rural producers.

II.2 Rural Financial System and Economic Development.

Financial sector development is germane to economic growth and, thus, poverty reduction (DFID 2004a and 2004b). Several studies have established the fact that a well-functioning financial system is critical to long term growth. Studies by Demirguc-Kunt and Levine (2004), Levine (1997), King and Levine (1993), Abu-Bader and Abu-Qarn (2005) and Habibullah and End (2006) had confirmed strong and positive link between financial development and economic growth. World Bank (2004) showed that national savings, i.e. aggregate income less total expenditure, and economic growth are positively related. Likewise, Fry (1995) confirmed positive correlation between the level of financial savings and economic growth. Savings are very critical in the domestic economy as they allow households to maintain precautionary balances against shocks. As noted by Marr and Onumah (2004), rural financial system enabled households build up cash collateral and the track record of saving that would allow them had easier access to credit. Most rural communities lacked secure and accessible deposit facilities and, consequently, savings were held as cash or assets. Such savings were harder to mobilize and did not increase availability of loanable funds (DFID, 2004c). Arising from this, rural entrepreneurs find it extremely difficult to access fund, and thus, have to rely majorly on self-financing.

With over 60 per cent of Nigeria's population engaged in agricultural production and living in poverty, the need for credit to support development of agriculture-based livelihoods has been emphasized. However, the rural economy is financially fragile. Lack of credit constitutes a binding constraint, limiting investment in productivity-enhancing technology and inputs. Asides, finance is needed for commodity marketing, sometimes through inventory-backed financing, which offers rural producers, traders and processors the opportunity to improve household income through adopting better produce marketing and raw material procurement strategies (Coutler and Onumah, 2002). Access to payment systems offered by the financial institutions affords the rural producers and traders opportunity of participating in modern, efficient commodity trading systems that offer better prices.

III. Challenges of Access to Financial Services in Rural Areas.

Several studies have identified major constraints to rural financial market development. These include Besley (1994), Hoff and Stiglitz (1990), and Demirguc-Kunt and Levine (2004). Some of these constraints are discussed below:

Higher risks: Credit risk is higher in rural areas both for borrowers and rural financial institutions. High and often covariant, risks in the rural economy are related to the dominance of agriculture, which accounts for a high percentage of the Gross Domestic Product (GDP), and employment (HDR, 2000). The revenues of rural households, whose incomes mostly depend on seasonal agricultural and livestocks production, are volatile due to several factors that affect production such as fluctuating weather conditions and pests or diseases. Besides, crop marketing systems in the rural areas are inefficient and small-scale farmers are exposed to greater uncertainty regarding the marketing of their output as a result of the liberalization of agricultural markets since the 1990s. As a result of lack of storage facilities, rural farmers often sell the bulk of their output at harvest when prices are low, leading to low and variable income. Similarly, the traders that form the link between producers and the wholesalers markets tend to be under-capitalized. Faced with limited access to trade finance from formal financial institutions, they often have to offer trade credit to wholesalers and processors. This usually creates a liquidity problem and limits their ability to absorb (and store) the substantial surplus available during the harvest season. The attendant glut often leads low farm gate prices with no market instruments to manage price risk.

Lack of credit information: Problems precipitated by uncertainty are exacerbated by lack of reliable information on the past credit history of borrowers. Indeed, credit information on rural borrowers is difficult to obtain as majority of them rely on moneylenders and other informal lenders. Asides, many rural customers do not keep record of their transactions. The unavailability of credit information to a very large extent constrains the flow of credit to the rural dwellers because performance risk measures are unavailable; and the current risk-management practice of banks is to control loan amounts.

Lack of collateral: Rural financial institutions can reduce the risk of loss due to uncertainty by demanding collaterals from borrowers. Collateral ensures that the lender can recover part, if not all, of his loan in case of default. In addition, it helped not only to reduce information asymmetries, but assist in screening out high-risk borrowers. However, many rural households either entirely lack collateral or do not have a legal title to their house or land. Financial institutions, thus, have no means of securing their credits against defaults. Defaulting clients run high risks as well. This is because financial institutions will typically impose punitive interest rates for delayed payments and might even confiscate assets of defaulting clients.

High transaction costs: The transaction costs of rural lending in Nigeria are high, mainly due to small loan sizes, high frequency of transactions, large geographical spread, the heterogeneity of borrowers, and poor infrastructure. Arising from the high level of poverty in the rural areas, the quantum of financial services needed tends to be small. The small sizes of rural loans, resulting in a high due-diligence cost per loan, exacerbated by the heterogeneity of borrowers, make it extremely difficult for formal financial institutions to cover costs. The clients also face other problems. For instance, as a result of poor infrastructure such as transportation, communication and information technology, clients have to travel long distances to deposit savings or repay a loan. As they usually travel on foot, this could cost them an entire working day. Rural financial institutions also face additional costs for ensuring security and managing liquidity. High unit costs are usually passed on to the rural clients thereby making them pay higher interest rates.

High rates of illiteracy: The rate of illiteracy is higher in the rural areas compared with the urban centres. Poorly educated people face an additional challenge in accessing financial services. It is difficult for them to analyse credit risks and the profitability of loan or savings scheme, to provide necessary documents for loan procurement and to understand conditions and contracts. Some institutions fail to communicate interest rates and commissions in a transparent manner, indeed some institutions have important information about the credit constraints, which can contain additional costs for borrowers in small prints, which are often ignored. In view of the various problems in the rural areas, financial institutions are faced with the difficulty of finding, hiring and keeping well-trained staff that will reside in them.

Weak legal framework and enforcement issues: Government has not been able to develop and enforce a legal and regulatory framework conducive to rural finance, so that contract design, contract renegotiation and contract enforcement remain weak, making it rather more difficult for financial institutions to provide clients with the right incentives for repayment. Land titling and registration systems are weak, and the use and transfer of land is difficult under the current framework.

Government policy: Before the mid-80s, several government policies, including interest rates, high fiscal deficits and sectoral lending controls contributed to the underdevelopment of financial markets and the supply of rural finance (Fry, 1995). Fiscal deficits led to government's appropriation of a large share of financial savings for itself, pre-empting credit to the private sector. Likewise, government's deficit financing policies provided bankers with opportunities to deploy bank resources in government securities, which are not only safe but also yielded high profits for banks in a falling interest rate environment. Furthermore, monetary policy interventions to contain inflationary pressure – usually through the sale of government debt instruments like treasury bills - tend to reduce the volume of credit available to the private sector as well as raise the cost of borrowing. Macroeconomic instability, often in the form of high inflation, is equally known to adversely affect financial development as it discourages saving in financial form (Khan, 2002).

IV. Meeting the Challenge of Increasing Access to Rural Finance.

Increasing access to finance for Nigerian's rural dwellers to meet their diverse financial needs presents a formidable challenge in a country as vast and varied as Nigeria. The first challenge relates to making the financial institutions introduce products and services that are flexible, reliable, convenient and available on a regular basis. Besides, there is the challenge of introducing measures that allow for low-cost ways of reaching the rural poor. Finally, there is the big challenge of introducing reforms in government policy to enhance the overall incentive framework, and of the regulatory as well as legal system within which rural banks operate, with a view to promoting greater efficiency and competition in rural finance.

Generally, rural finance can be promoted by supporting informal schemes such as community-based savings groups, as well as by fostering formal institutions through technical assistance (supply-side measures) and assisting poor households and small enterprises in accessing financial services (demand-side measures). Besides, donors can provide support to the development of favourable policy and regulatory frameworks. Some specific programmes to enhance increased access of rural dwellers to finance under the broad groups mentioned above are highlighted below:

Introduction of flexible and easily accessible products: There is the need for banks to introduce flexible and easily accessible products. Rural households and small entrepreneurs have specific needs which vary from those of urban clients as most of them depend on agricultural cycles. It has been shown that rural clients prefer to borrow frequently, and repay in small instalments. By implication, the savings and repayment mechanism that are being promoted by urban microfinance institutions are not likely to work effectively for the rural clients. This simply means that the formal financial institutions need to explore the possibility of offering new and more flexible loan products. In particular, financial institutions need to understand the cash flow of rural households and offer adapted loan repayment and savings collection schemes.

Besides, the banks' branches in the rural areas will need to explore opportunities of offering composite financial services as they do in the urban areas. It needs be pointed out that the rural clients, not only seek savings and lending activities but also, seek insurance such as health, life and crop. Moreover, in view of the increasing volume of international remittances flowing into the country in recent years, rural financial institutions need evolve remittance services to take care of their clients. Efforts at reducing the transaction costs and increasing the availability of remittance services through expanded bank branch coverage will not only assist in generating new businesses but also help in weaning away customers from using informal channels for remittances.

Moreover, financial institutions have to be innovative to reduce costs. Innovative distribution channels such as mobile branch offices or bank-counter located in rural post offices and shops can assist in reducing the fixed costs of operation. Aside from this, the use of information technology such as handheld computers or mobile phones is a major way of reducing transaction costs. Also, as part of innovation, there is need to simplify the procedures to open bank account and other banking procedures. These will not only help in reducing transaction costs, but also serve as incentive for rural households to bank with the formal financial institutions.

Provision of favourable enabling environment: An enabling and conducive environment is a prerequisite for an efficient financial system and effective rural development and poverty reduction. At the macro level, a number of factors are very important for preventing systemic risk. This entails implementation of measures (monetary, fiscal, financial etc) to achieve basic macroeconomic goals such as high growth rate, low inflation and low unemployment rate. Macroeconomic policy measures that promote growth and poverty reduction will ensure increased financial flow to the rural areas. Expansion of income that leads to increased domestic consumption and investment will expand the range of production activities for the rural dwellers, thereby providing the small entrepreneurs the opportunity to enter the market. Moreover, monetary policy interventions to contain inflationary pressures will lead to stability and growth, which will impact positively on the cost of fund, thereby lowering the cost of borrowing for rural clients.

Building on the existing infrastructure: One major component of high transaction cost is transportation expenses. This tends to be high due to the fact that many borrowers are located at long distances from the loan offices. When the opportunity cost of labour, in terms of the work time lost, is taken into consideration in the computation of the borrowers' transaction costs, the loans will be very expensive to the borrowers. This equally poses a big challenge to the financial institutions as they find themselves spending considerable time visiting areas that are sometimes remotely located. This explains why provision of roads is very critical to increased rural access to finance. Provision of roads will lead to reduction in transaction costs of inputs and outputs, thereby leading to an increase in agricultural output, crop area and yield. Moreover, agricultural output itself is limited by inadequate off-farm, "upstream" and "downstream" facilities. Better infrastructure can stimulate rural income by lowering the costs of trade with the country's urban areas and foreign markets. Infrastructural development will help to integrate the remote rural areas into the broader market, thereby contributing to the marketization and profitability of agriculture. It will assist in promoting information flows between communities in rural and urban areas, thus, linking farmers to market for goods, input supplies, and agricultural extension services.

Additionally, financial institutions should adopt the policy of risks minimization. It is true that financial institutions in the rural areas lack collateral or the possibility to legally enforce contracts. However, they can use social links (for example through group savings and lending) to reduce their risks. The so-called linkage model combines informal systems, such as self-help groups, with formal banks. Groups are linked to the bank through a group contract, so the bank does not have to deal with each client separately (Inforesources, 2008). Adopting this approach will help the financial institutions to reduce their risks and transfer transaction costs to the self-help group. Also, there is the suggestion that collateral can be created in the rural areas through warehouse receipt systems (Coutler and Onumah, 2002), with a view to taking care of the problem of lack of collateral in the rural areas. Warehouse receipts is defined as documents issued by warehouse operators as evidence that specified commodities (of stated quantity and quality) have been deposited at particular locations by named depositors (Coutler and Onumah, 2002). The depositor may be a producer, farmer group, trader, exporter, processor or indeed any individual or corporate body. The commodity remains the property of the depositor until sold at market, while the warehouse operator can extend credit in the form of cash to people who deposit commodities in his warehouse. Several benefits of the system have been noted in the literature. These include: provision of opportunity for lenders to mitigate credit risk by using the stored commodity as collateral; reduction in transaction costs, thereby encouraging commercial lending to the rural sector; and provision of opportunity for farmers to market their crops and get a better price as they could defer sale of produce until prices rise after the traditional harvest season (Coutler and Onumah, 2002). All the same, the system has its own disadvantages. One, it tends to exclude smallholders and small-scale traders. Two, lack of regulatory oversight of the collateral managers could lead to fraud, which might discourage inventory-backed financing by banks.

Finally, there is a need to scale up microfinance in the provision of rural finance. As various efforts are made towards improving formal financial sector's ability to serve the poor, microfinance can play an important role in filling the gap. Indeed, they offer the potential for sustainability and growth. Moreover, arising from their demonstrated success in providing benefits to the poor, international donors and governments are more disposed to supporting microfinance institutions. This explains why the activities and operations of these institutions need to be scaled up. Scaling up access to finance for Nigeria's rural poor through microfinance will require attention in the following areas: an enabling policy, legal and regulatory environment for microfinance, attention to group quality, and the importance of financial sustainability, appropriate products and services, and good staffing and geographical distribution of the microfinance institutions.

Scaling up microfinance will also require partnership between civil society, government and its institutions as well as donors to provide seed resources for expansion of these services. It also entails commitment of grant resources to help offset the overhead cost associated with operating these facilities. This is because experiences have shown that even in the case of Grameen Bank, the pioneer in this endeavour, the bank remains constrained by high expenses per unit transacted, and relies on donors and socially- conscious investors (Murdock, 1999).

Studies have also emphasize the need for governments, in collaboration with NGOs and private sector that are involved in agro-allied businesses, with the support of international donor agencies, to facilitate the establishment of Farmer Support Services (FSS) in the rural areas to assist farmers in accessing credit. Such service could be made available through microfinance facility, technical assistance, trainings and marketing information.

V. Conclusion

Rural finance is now recognised as an important tool in the fight to reduce poverty, increase growth and enhance donors' development effectiveness agenda. It encompasses all savings, lending, financing and risk-minimising opportunities (formal and informal) and related norms and institutions in rural areas. In addition to fostering rural development, rural finance is increasingly used as an incentive to promote sustainable use of natural resources, use of alternative energies, and environmentally-sound behaviour. However, despite the importance of rural finance for growth and the significant demand for financial services, financial service providers, such as banks, credit unions, microfinance institutions or insurance companies, are typically reluctant to serve rural areas. Consequently, majority of the country's rural population does not have access to the formal financial system.

The reluctance of financial institutions to serve rural areas is not unconnected with the various challenges involved in such endeavour. These challenges include the weak infrastructure and low population density that characterized the rural sub-sector. The capacity of financial service providers and the level of client education in rural communities are quite limited. Moreover, financial institutions are tardy in granting loans to the agricultural sector given its seasonality and the inherent risks of farming. These challenges explain the high transaction costs and the risks inherent in serving the rural areas by the financial institutions.

It, therefore, becomes imperative to address these challenges so as to enhance rural dwellers' access to finance. A new approach to rural finance must focus on building the sustainability of the financial service providers, thinking beyond the short life cycle of donor-driven projects. The financial institutions must develop appropriate market-based innovative products and strategies that will enhance the level and quality of financial services rendered to the rural sector of the country. This would require that the government addresses the issue of environment, especially, the provision of necessary infrastructure, developing appropriate policies and programmes that benefit the majority and allowing privately-managed institutions to evolve.

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The Millennium Development Goals: What Role for the Financial Sector in Nigeria

*Jonathan Aremu, Ph.D**

I. Introduction

When 189 Heads of State and government from the North and South, as representatives of their citizens, signed to the Millennium Declaration in 2000 at the UN Millennium Summit, there was a sense of the urgency was to "free our fellow men, women and children from the abject and dehumanising conditions of extreme poverty, to which more than a billion of them are currently subjected." The Summit therefore adopted the Millennium Development Goals (MDGs). The content of the MDGs provide concrete, numerical benchmarks for tackling extreme poverty in many dimensions. It also provided a framework for the entire international community to work together towards a common end by making sure that human development reaches everyone and everywhere in the global space.

The Goals represented human needs and basic rights that every individual around the world should be able to enjoy, including freedom from extreme poverty and hunger; quality education, productive and decent employment, good health and shelter; the right of women to give birth without risking their lives; and a world where environmental sustainability is a priority, and women and men live in equality. The leaders also pledged to forge a wide-ranging global partnership for development to achieve these universal objectives by believing to use the first 15 years of the new century to begin a major onslaught on poverty, illiteracy and disease. They gave a clear measure of success or failure via the MDGs targets. To them, the achievement of those targets by 2015 would not mean the battle for development had been won, but failure to achieve them, implies that they are losing. Most regions were expected to meet many of the MDGs by 2015, while sub-Saharan Africa and South Asia were to be seriously off track (World Bank, 2006).

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Recognising the importance of financial sector in the implementation of MDGs, the United Nations General Assembly adopted 2005 as the International Year of Microcredit to "address the constraints that exclude people from full participation in the financial sector"(UNO, 2005). At the World Summit of the United Nations in September 2005, Heads of State and Government recognised the need *for access to financial services, in particular for the poor, including through microfinance and microcredit*. Earlier, at the Monterrey Consensus, the Heads of State and Government had adopted at the *International Conference on Financing for Development in 2002* where they explicitly recognised that "microfinance and credit for micro-, small and medium enterprises…as well as national savings schemes are important for enhancing the social and economic impact of the financial sector". This is why Kofi Annan (2003) said, for development, you need resources such as: human resources; natural resources; and, *crucially, financial resources*. The Conference, therefore, recommended that development banks, commercial banks and other financial institutions, whether independently or in cooperation, can be effective instruments for facilitating access to finance, including equity financing.

To these leaders, the world possesses the required resources and human knowledge to ensure that even the poorest countries, and others held back by disease, geographic isolation or civil strife could be empowered to achieve the MDGs. Meeting the goals is, therefore, everyone's business. Falling short would multiply the dangers of the entire world – from instability to epidemic diseases to environmental degradation. But achieving the goals will put all humans on a fast-track to a world that is more stable, more just, and more secured. They equally believed that the Goals are achievable when nationally owned development strategies, policies and programmes are supported by international development partners.

In most developing economies, including Nigeria, financial services are only available to a minority of the population. Although financial sectors are expanding as these economies grow, financial assets usually remain highly concentrated in the hands of a few. Majority of the people in these countries have no savings accounts, do not receive credit from a formal financial institution, and have no insurance policies. They seldom make or receive payments through financial institutions. The limited use of financial services in developing countries has become an international policy concern. Indeed, the

Heads of State and Government meeting at the September 2005 World Summit at the United Nations stated that: "We recognise the need for access to financial services, in particular for the poor, including through microfinance and microcredit" (United Nations, 2005). This reflects what must be — and increasingly is — a concern of development and poverty eradication policy at national and local levels: the recognition of the important contribution a broad-based financial sector makes to economic development and poverty alleviation.

The basic question is: why are so many bankable people unbanked? But who are the bankable unbanked? Who are the people and firms who are excluded from full participation in the financial sector — those who should be, but are not using formal financial services? They are creditworthy people and firms who would be able to generate income to repay what they borrow, but who do not have access to credit. They are insurable people and firms who have the income to pay for group or individual insurance premiums on a regular basis, but who do not have access to insurance. The largest group of unbanked people is the group who want a safe place to save, build assets and a reliable way to transfer and receive money, but who do not have access to savings or payment services.

Although financial development has economy-wide effect, broad access to finance for households and firms is necessary to reap its full benefits. It is understandable that financial development and greater access to financial services do lead to income growth, reduce poverty and undernourishment, and are associated with better health, education, and gender equality (components of MDGs). However, despite the apparent benefits of finance, available evidence in Nigeria still show that financial services are far from universal to the teaming population of the country. Although access to finance is increasing with the various recent initiatives and innovations of the Central Bank of Nigeria (CBN), there are still several factors that impede poorer households and smaller firms to fully utilise the financial system. With 3 years left to the fulfilment of the MDGs promises, Nigerian financial system has a crucial role to play if the economy is to meet the targets envisaged in the MDGs.

The purpose of this paper, therefore, is to redefine the role of the Nigerian financial sector towards meeting the MDGs by 2015. The paper is, thus, structured into four parts. Part I, briefly analyses the targets of the MDGs and the situation in

Nigeria. In part II, an attempt is made to examine the various areas where the financial sector can offer helping hands in the implementation of the MDGs targets in Nigerian economy. While Part III examines the reasons why financial services in Nigeria are not within the reach of the MDGs target group (the poor), Part IV addresses the various measures to improve the financial services sector towards the inclusion of the poor to meet the MDGs targets. Part V concludes the paper with some recommendations.

II. The Millennium Declaration and the Targets

At the Millennium Summit in September 2000, 189 nations unanimously adopted the Millennium Declaration. The Declaration contains eight specific MDGs (Appendix I). The main aim of the MDGs is to eradicate extreme poverty around the world by 2015. As such, the MDGs are the most ambitious and most broadly supported development goals the world has ever established. The importance of the MDGs cannot be overstated. First, as reflected in the Millennium Declaration, there is a moral obligation to "free our fellow men, women and children from the abject and dehumanising conditions of extreme poverty, to which more than a billion of them are currently subjected." Second, poverty reduction matters for security and stability. Research shows, for example, that a negative shock on income growth increases the probability of a civil war. Third, economic prosperity for the poor creates new global growth opportunities by unlocking new consumer markets and entrepreneurial activity.

II.1 Relationship between the MDG Targets

Adopted in 2000 at the Millennium Summit (see Appendix 1), the eight MDGs are articulated along 8 goals. Each of the eight MDGs in turn, is consist of several targets, leading to a total of 18 targets, and each target is measured by several indicators, giving a total of 48 indicators. No doubt, the prime focus of the MDGs is on income poverty since it plays a central role in attaining the other targets. That is, although the MDGs are formulated separately, they closely relate to each other. For instance, higher household income enables children to go to school, and improves a household's access to health care needs. In turn, better health and education make people more financially productive, raising their incomes. Better health and education and higher income of women have a higher effect on household welfare, compared with the improvements in these same indicators for men, suggesting that gender inequality affects health and education impacts on overall economic outcomes. Thus, reducing poverty plays a central role in attaining the MDGs.

Although poverty has several dimensions, including health and environmental aspects, people are generally defined to be poor if they fall below a certain minimum level of daily income, that is, below a certain poverty line. Internationally, the most commonly used measure of poverty is a daily income of US$1 or US$2 a day, corrected for purchasing power. Because of this high correlation, income poverty is a good proxy for the shortfall on the other MDGs. When households are richer, they can afford more access to goods like nutrition, education, and health care, thereby achieving better outcomes on these MDGs. With higher income, households are also better able to invest and enhance their productivity and thereby increase their income further. Investments can vary from using fertilizer (to increase crops' productivity) to getting more education to increase wage income. In turn, by being more productive, people are more likely to increase their income and escape poverty.

II.2 Report on the MDGs in Nigeria

According to Nigeria MDGs Report (FGN, 2010), the trends in progress towards the MDGs are mixed, just as the prospects of meeting the respective MDGs 2015 targets are variable. Some MDGs indicators (such as universal primary education, prevalence of HIV/AIDS and ratio of girls to boys in primary education) show encouraging trends and prospects. The outlook for achievement of MDG8 (particularly with respect to debt sustainability and access to information and communication technologies) is positive and looks set to improve further. On Goal 8, the expenditure of debt relief gains on MDG-related investments has shown that Nigeria can have a significant impact on all goals in a relatively short time. In addition, debt relief has contributed significantly to the near-total eradication of polio in the country, a significant drop in maternal mortality and the recruitment of 74,000 primary school teachers.

However, other indicators such as those for primary school completion rates and access to improved water supply and sanitation, showed poor trends and wide deviations from the targets. Reversing these undesirable trends and accelerating progress towards the MDGs 2015 targets would require bold measures to enhance service delivery, scale up investments, rationalise resource allocation, improve implementation coordination and improve the quality of government spending.

Adequate, reliable and timely data, (according to the report) is a prerequisite for accurately measuring and tracking the MDGs. But there are MDG indicators that have not been adequately evaluated due to large gaps in the data. These data deficiencies are most pronounced with respect to MDG1 (poverty and hunger) and MDG7 (environmental sustainability). Existing poverty estimates are based on 2004 survey results, while many environment-related indicators cannot be assessed because of lack of data. Nevertheless, data availability has generally improved, thanks to the efforts of the National Bureau of Statistics (NBS) in gathering, collating, coordinating and reporting data. There is still much scope for improving the adequacy, reliability and timeliness of data, as shown by the progress that has been made in recent years.

The outlook for data on MDGs will depend largely on progress in creating results-based monitoring and evaluation, and political commitment for sustained implementation of the

Table 2.2: Progress towards MDG targets and current status (June 2010)

Table 1: Progress towards MDG targets and current status (June 2010)	
Goals	**Status**
1. Eradicate extreme poverty and hunger diseases	**Slow:** There is less poverty than in 2000 but the data is not clear. Five out of every ten Nigerians still live in poverty. Growth has not been sufficiently equitable or generated enough jobs to reduce poverty further. Nutrition has improved significantly.
2. Achieve universal primary education	**Average:** Many more children are in school. Nine out of every ten eligible children attend school as a result of Universal Basic Education Programme interventions and enrolment in private schools. However, disadvantaged groups are still excluded and the quality of education remains poor.
3. Promote gender equality and empower women	**Average:** Some improvement in gender parity. Nine girls attend school for every ten boys. Economic and political empowerment remains elusive. A common reason for the

	disparity in rates of girls and boys completing schooling, especially at secondary level, is poor or non-existent water and sanitation facilities.
4. Reduce child mortality	**Average:** Significant reductions but progress needs to be accelerated.
5. Improve maternal health	**Slow:** The data for 2008 show a significant improvement, but the gap between the current situation and the target is still very large.
6. Combat HIV/AIDS, malaria and other	**Average:** The prevalence of HIV/AIDS in the population has fallen from 5 per cent to under 4 per cent. Rates of malaria infection have dropped, but still account for 300,000 deaths a year, on average. The hard work is still to come. Impressive progress against polio.
7. Ensure environmental sustainability	**Slow:** Access to safe water and sanitation has not improved significantly and other environmental challenges, such as erosion, coastal flooding and climate change, are growing.
8. Develop a global partnership for development	**Average:** The benefits of debt relief have not been matched by an increase in aid. Trade and access to markets is still unequal. Rapid increase in access to information and communication technologies, tele-density and regional initiatives (New Partnership for Africa's Development, Economic Community of West African States, etc.).

National Strategy for the Development of Statistics (NSDS) 2010-2014. It is expected that, in succeeding years, the data system will become better aligned with the measurement needs of the MDGs. Disaggregated analysis of data to regional level has shown wide disparities and inequalities across states and zones. The MDG indicators with the greatest state-level disparities include poverty, gender equality, universal primary education, maternal mortality and infant mortality. In essence, low-performing states are a drag on national progress towards the 2015 targets. Without significant improvements in low-performing states, it will be difficult to achieve the national targets.

The lesson for the national achievement of the MDGs is that there is a compelling case for better targeting, and greater coordination and synergy between federal, state and local governments. There is much scope for context-specific ameliorating measures by state governments, complemented by matching incentives from the federal government. It is, therefore, crucial to build the capacity of state governments to design and implement MDG interventions. In particular, it is important to leverage potential positive interactions of the MDG indicators.

The debt relief-funded Conditional Grants Scheme has shown itself to be an effective mechanism for delivering transfer of funds from the central to the local level. It has also encouraged governance reform that is critical to service delivery at the local level and, therefore, to progress on the MDGs. Improved macroeconomic performance over recent years has brightened the prospects for the MDGs in Nigeria. However, the global financial and economic crises and the imperative of adapting to climate change constitute additional challenges in the march to the 2015 targets. Besides, the macroeconomic and fiscal effects of the global financial and economic crises, there are potentially significant effects on household incomes, employment and assets. As governments take measures to ameliorate the negative fallout of the crises, it is important to ensure that short-term reactive measures do not undermine longer-term growth and development prospects.

Five years from the MDGs target date, the report concluded that this stocktaking is an important basis for Nigeria to chart a course for accelerated action on the MDGs. Given the shortfalls in achievements, and looking towards the targets, Nigeria needs a big push forward. Progress on some indicators has shown that targeted interventions matched with adequate funding and political commitment can make a difference. With this position of the report, the importance of financial services become very crucial. Perhaps, this is why the CBN has requested that this paper be presented.

II.3 Policy convergence of Nigeria's MDGs and Financial Systems strategies

Having observed and reported the trend in the country to achieving the MDGs in the 2010 Nigeria MDG report, the MDG Office in Nigeria has developed a Countdown Strategy (CDS) which aims to identify areas of emphasis for the Nigerian government towards achieving the MDGs or at least bring on track specific programmes and strategies that will enable the right investments and policies towards achieving the MDGs. This strategy document proposed ways and outlined specific policy areas as well as investment plans that would ensure the achievement of the MDGs even though it recognised that the plans are ambitious. There were several convergence areas outlined in the document, including aligning the CDS with the 7-point Agenda and Vision 20:2020. The Transformation Agenda is apparently a modification of the Medium Term Development Strategy 2009-2011, and as such also aligns with the core objectives of the MDGs. The following strategies would be implemented include:

- Professionalizing agriculture to attract youths and new graduates in the areas of production, processing and marketing;

- Breeding and distributing high-yielding and disease-resistant species of crops, livestock and fish;

- Achieving an efficient agricultural extension system by increasing the ratio of extension agents to farmers to 1:500 by 2013;

- Accelerating the growth of the economy, ensuring a stable macroeconomic environment, ensuring an enabling environment for a market-based, private sector-driven economy and ensuring pro-poor economic policies;

- Instituting policies and programmes specifically designed to eradicate extreme poverty and hunger, such as youth empowerment and conditional cash transfer schemes, conditional grants to state governments, and Presidential initiatives on various agricultural commodities and Microfinance. In addition, putting in place a robust evaluation framework to improve the quality of programmes and encouraging rapid scaling-up when they deliver good results;

- Speeding up improvements in infrastructure, services and human resource capacity, particularly in rural areas;

- Increasing investments in agriculture, promoting modern equipment and technology transfer to attract the younger generation to the sector, and strengthening industrial processing technology and market linkages to boost employment and income from agriculture;

- Establishing community-based care schemes to strengthen social security for the elderly; and

- Urgently improving all coordination, monitoring and evaluation of poverty eradication efforts throughout the country.

Examining the strategies as outlined above, it is apparent that the objectives and strategies are deliberately skewed in favour of the poor, particulary in the rural areas. In terms of envisioning the role of the financial sector, specific mention of "microfinance" was made to the extent that it is a deliberate strategy at achieving poverty eradication through access to finance. This strategy, though not elaborated has been recognised globally to be a major driver of access to credit and financial services by the very poor.

In the case of the Financial Systems Strategy (FSS 2020) led by the CBN in relation to the MDGs, it can be said that the financial services sector is aiming at stimulating growth in the Nigerian economy with the consciousness that economic growth would transform the standard of living of its people by deliberately focusing on identified "drivers" whose immediate development would enable the financial sector to catalyse growth in other parts of the economy. Capital markets, micro, small and medium enterprise finance credit, mortgage, insurance, money markets, foreign exchange markets in the economy which include the SMEs have been identified. What remains to be seen is whether the development strategy of the financial sector is deliberately skewed in favour of the poor. This is not as apparent as it is for the MDG CDS. This is a major factor in terms of policy alignments in the sense that financial services development with all its potential to enhance growth can actually exacerbate poverty in the country if the income inequality index is high.

Examining the ways in which the financial services sector within the overall scheme of inclusive financial services development can catalyse the process of achieving the MDGs is indeed a very crucial subject. This will enable targeted approach to channelling the various operations of the financial sector poverty eradication which in turn will boost the deepening of the financial services sector.

III. Importance of Financial Sector Services Towards Reaching the MDGs Targets

It is known that the financial sector consists of all the wholesale, retail, formal and informal institutions in an economy offering financial services to consumers and businesses. In its broadest definition, it includes everything from banks, stock exchanges, and insurers, to credit unions, microfinance institutions and money lenders in the economy. Access to a well-functioning financial system can empower individuals, in particular poor people, allowing them to be better integrated into the economy, actively contribute their quota to national development as well as protect themselves against economic shocks. Thus, the creation and expansion of financial services towards the poor and low-income population of the economy can play a vital role in the overall economic development of the country. Expanding and deepening financial services development for poor people should simultaneously be a concern of poverty reduction and financial sector strategies. In this way, inclusive financial sectors (where no segment of the population is excluded from accessing financial services) can contribute to attaining the goals contained in the MDGs.

There are many different ways in which inclusive financial sector development in Nigeria will be of interest to the MDGs. These include when the:

- efficiency and competitiveness of the sector is improved;
- range of financial services that are available is increased;
- diversity of institutions which operate in the financial sector is increased;
- amount of money that is intermediated through the financial sector are more;
- extent to which capital is allocated by private sector financial institutions, to private sector enterprises, responding to market signals (rather than government directed lending by state-owned banks), is enhanced;
- regulation and stability of the financial sector improve; and
- greater of the population (particularly , the poor) gain access to financial services.

The reason why financial development matters for the MDGs is straightforward. It enables more productive allocation of capital to the poor and small firms, which in turn facilitates meeting many of the MDGs. Under efficient and well-functioning financial markets in the country, firm characteristics such as: size, ownership, and profitability do not matter for new investments. All potential projects with attractive economic returns qualify to receive financing from the financial markets regardless of the firm that plans to undertake them. The same applies to households. With well-developed markets, it is only the expected economic return on new investments of the household that matters to receive bank assistance. Other household characteristics such as current income, wealth, education, gender, and ethnicity, become irrelevant. With this development, both the rich and poor can reap the full benefits of financial markets. Financial services would then enable households to be more productive, as households can borrow for investment not only in real assets, like fertilizer, a tractor, or a computer, but also for education, health, and other services that add to their productivity and high economic returns.

Consequently, access to financial services can enhance individuals' nutrition and health, and could allow people to send their children to school. Self-employed women with access to financial services are better able to control their economic destiny and gain more influence in their households and communities, thus, often aiding gender equality. In addition, the benefits of financial sector inclusion to all extend beyond financing investment, and actually often start by offering better and cheaper payments and savings services. These services allow firms and households to avoid the costs of barter or cash transactions, reduce the costs of remitting funds, and provide the opportunity to accumulate assets and smooth income. Insurance services can help firms and households cope with shocks and reduce their vulnerability to adverse situations, thus mitigating the risk of falling into poverty.

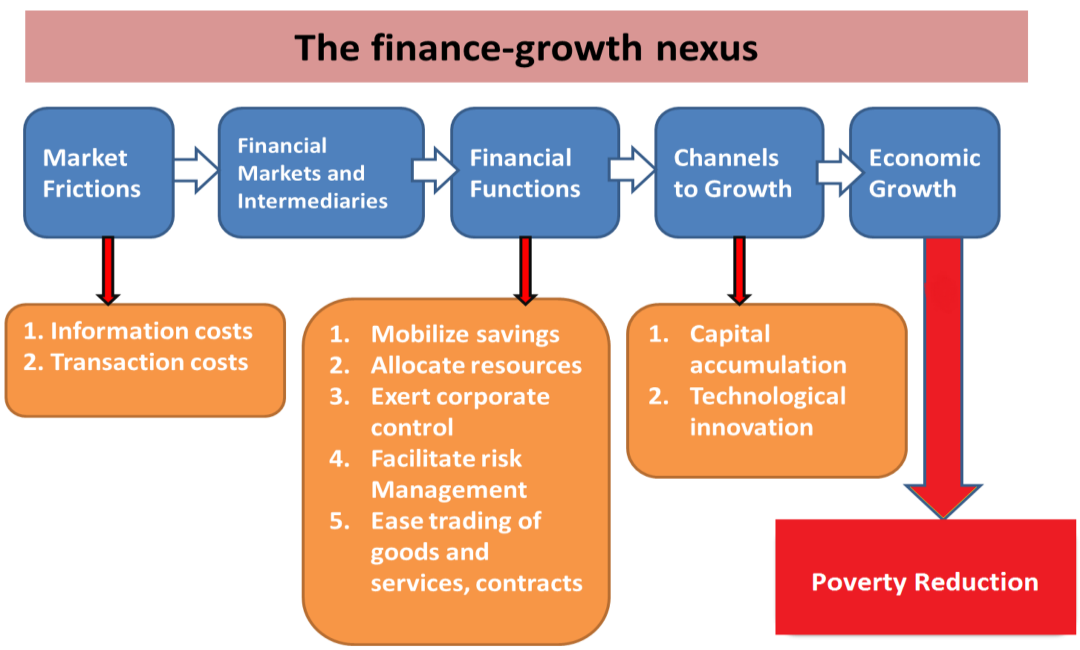
From the above, financial sector has an important role to play in achieving the MDG targets by:

❖ mobilising savings for productive investment, and facilitating capital inflows and remittances from abroad, the financial sector has a crucial role to play in stimulating investment in both physical and human capital, and hence increasing productivity;

❖ reducing transactions costs, facilitating inward investment, and making capital available for investment in better technologies, the financial sector can promote technological progress, thus, increasing productivity, and improving resource use;

❖ enabling the poor to draw down accumulated savings and/or borrow to invest in income-enhancing assets (including human assets e.g. through health and education) and start micro-enterprises, wider access to financial services generates employment, increases income and reduces poverty; and

❖ enabling the poor to save in a secure place, the provision of bank accounts (or other savings facilities) and insurance allows the poor to establish a buffer against shocks, thus, reducing vulnerability and minimising the need for other coping strategies such as asset sales that may damage long-term income prospects.



Source: Adapted from Ozer (2008)

From the above, it is clear that financial development improves the financial services sector in a country so that it can allocate capital between lenders and borrowers more efficiently. Since more developed financial sector promotes economic growth (Levine, 2004), financial development may indirectly help achieve the MDGs also by stimulating growth. Recent research has also shown that financial development directly reduces poverty without increasing income inequality (Beck *et al*., 2004; Rosner, 2010). There are several dimensions in relation to the MDGs that the role financial services sector can be viewed from. These include:

A. Financial services and income growth;
B. Financial services and poverty reduction;
C. Financial services and health;
D. Financial services and education; and
E. Financial services and gender equality.

III.1 Financial Services and Income Growth

The financial sector development can contribute to income growth. Nobody doubts that income growth leads to improvement in people's lives because increased income allows people to enjoy better living standards and escape from extreme poverty. This in turn enhances the productivity of the people. In addition to providing efficient allocation and low-cost financial services, a well-developed financial sector screens potential investments, and monitors as well as produces information about the behavior of users of capital.

III.1.1 Financial Services Development Can Stimulate Private Sector

a) Effects on productivity and capital accumulation

When financial services develop, they are likely to lead to growth via: an increase in the savings rate as people could earn higher returns; increase in investment and capital accumulation (i.e more and better machines) as financial intermediaries raise more funds; and increase in total factor productivity as resources are more efficiently allocated. Essentially, because financial development facilitates the funding, finding, and monitoring of investment opportunities, it leads to a greater and better allocation of capital. In addition such development facilitates better risk-sharing; and as a consequence, investors are more willing to put their money in high-risk, high-return projects.

b) Effect on competition and innovation

Schumpeter (1964) argued that a developed financial sector provides entrepreneurs with the means to research and implement good ideas. As such, finance is key to effectively increase competition and innovation to enhance growth. Much empirical evidences support this role of finance. In this manner, financial development does induce technological innovation.

c) Effect on transaction costs

Financial systems provide many transaction services, from domestic payment services to international remittances to facilitating (international) trade transactions. Gains from better transaction services through more developed financial systems can be large. Today, development in the financial services has led to electronic payments system which is quite cheaper than cash transaction.

III.1.2 Risk-sharing and Lowers Volatility

It is understood that financial development results in lower GDP volatility, because investors and lenders can share risks better, and hence, absorb economic shocks more easily. Better risk-sharing makes investors more willing to invest in higher-risk, higher-return projects, and consequently enhancing growth. In addition, a well-developed financial system means fewer financial crises in the following areas:

a) Risk absorbing and sharing effect

A developed financial sector is able to spread risks widely, so that many economic agents bear a small portion of any economic shock, leading to more GDP stability and higher growth. This is through insurance products and sophisticated financial instruments that ensure that risks will be carried by those who are able and willing to do so. The risk reduction comes about more generally through the services a financial system offers. Spreading of these risks using financial markets can lead to more investment in long-term, high-return projects, which boosts economic growth. In addition, better financial markets can lower output volatility, because long-term projects will be less frequently terminated due to liquidity problems in recessions as termination would only amplify the recession.

b) Enhance more investment and high-return projects

High volatility has a negative effect on investment because it makes predicting returns on (long-term) investments more difficult. In addition, long-term investments tie up money, exposing investors to the risk of not having money available to absorb sudden income shocks (liquidity risk). Spreading of these risks using financial markets would clearly lead to more investment in long-term, high-return projects, which boosts economic growth.

c) Reduction of financial crises

Financial systems largely rest on contracts that promise to exchange money now for repayment in an uncertain future. This makes the banking systems to be especially fragile, as banks fund themselves with short-term deposits and investments in long-term. Furthermore, banks are subject to moral hazard. This fragility has resulted in financial crises from time to time in many countries. However, a more developed financial sector is far less fragile and has seen fewer crises. The real costs associated with a crisis can be high as financial sectors function poorly in the wake of a crisis. Good borrowers are excluded from credit, which reduces growth, and depositors may lose their savings due to bank default or high inflation, reducing the supply of savings available for intermediation. All these will slow the growth of the real sector which in turn entrenches poverty.

III.2 Financial Services and Poverty Reduction

Financial sector development does not only lead to growth, nor does it just benefit the rich alone; but that the poor can equally benefit substantially when the services in the sector improves. As explained in Rosner (2010), financial development can reduce poverty in 3 ways:

First, it could enable more people to access credit. In Nigeria, as in other developing countries, financial market imperfections hinder people with profitable projects from obtaining the credit to fund them. Information asymmetries make it difficult for banks to determine the risks of different projects. Borrowers need to provide collateral to convince banks to lend to them. The poor do not have the assets to put down as collateral and, thus, cannot access credit to invest in profitable projects. Financial development may help the poor by reducing market imperfections that constrain credit.

Second, financial development has traditionally reduced transaction costs in the economy by increasing the amount of money in the economy. Trading real goods for each other in barter systems is costly because of the need to find trading partners and to store and transport goods. A system of exchange based on money is more efficient as it reduces these costs and promotes trade. Therefore financial development has helped the poor by reducing transaction costs in the economy.

Third, financial development can enable more people to deposit their savings. McKinnon's (1973) "conduit effect" states that if the poor could deposit their savings in financial institutions and earn interest, they would be able to accumulate wealth to invest in profitable projects. Therefore, financial development may also reduce poverty by enabling people to save their income in deposit accounts.

III.3 Financial Services Development and Poverty Reduction

Poor people generally have worse access to finance while they stand to gain from improved access to financial services. For one, access to financial services can provide income as it reduces costs. Access may also increase income due to higher productivity and dampen income volatility due to better insurance. These impacts could be seen from the various forms of financial services such as: payment services, savings, credit, and insurance.

a) Payment services

Payments via a developed financial sector can be cheaper, easier, and safer than cash payments. For example, a well-developed financial sector provides transcripts to prove payment and protects parties from theft, and reduces travel costs. This facilitates and increases transactions between parties, especially those who are unfamiliar with each other. Cash payments are more common among the poor, however. They, thus, incur costs of being unbanked. For example, households are often charged a fee for the services of a money middleman. One important function of the payment system is the transfer of funds, including remittances. However, making remittances is much more expensive for the unbanked.

b) Savings

Saving is important for households to weather difficult times, like drought, damages, and fire; and to plan for the future, such as accumulate for a dowry. However, poor households often have risky, low-yield informal savings in the form of livestock, jewelry, cash, and deposits in rotating savings and credit associations. Investment in livestock is risky and inconvenient because animals are susceptible to illness and can only be sold entirely, even when a household only needs a small amount of cash. Besides being risky, these forms of savings are often costly, implying a low or negative real (inflation-adjusted) yield. Hence, when the financial sector functions properly, it enables households to diversify their savings over deposits, bond markets, and stock markets (and real assets) with more attractive yields.

c) Credit

Affordable credit can help households overcome shocks like illness and death, "smooth" their consumption, and give them the opportunity to invest and increase their productivity. For example, credit empowers would-be entrepreneurs and enables households to buy fertilizers, better seeds, tractors, and education services for their children. In turn, higher (agricultural) productivity and higher incomes provide households with access to better nutrition, reducing the prevalence of undernourishment.

d) Insurance

Volatility of household income, especially the poor, can be high due to fire, theft, drought, illness, death, among others. When there are ideal insurance markets, people need not suffer from unavoidable risks. For example, if people in an isolated village could insure each other perfectly, individual income volatility should only respond to village-level income fluctuations and not to shocks to individual incomes, because these can be absorbed by the village population as a whole. Shocks can have a severe impact on poor households' welfare, since they often do not have any other cushion of assets.

III.4 Financial Services in Stimulating Economic Growth and Income Disparity

According to World Bank (2002), in 2001, GDP per capita in the world was on average about US$21 a day, while in the same year, more than half of the world population lived on less than US$2 a day, and more than 1 billion lived on less than US$1 a day. Based on this revelation, poverty reflects the unequal distribution of income around the world. Besides a globally unequal distribution, poverty at the individual country level is, in turn, driven by a combination of lack of economic growth, as measured by GDP per capita, and an unfair income distribution, as measured by inequality. Inequality matters because poverty could be high despite a high level of GDP per capita if inequality is high as well. Financial services development reduces poverty via economic growth, as already discussed above. It also reduces inequality because access to financial services provides a level playing field for all and gives the poor better opportunities to participate in the (formal) economy. Financial services development could be associated with a lower poverty ratio by broadening the opportunity of all to participate in productive economic activities, particularly when new inclusive financial products are introduced into the market.

In terms of inequality, the beneficial effects of financial development for the poor come about in an indirect way, even when they do not have direct access to financial services. The effect of financial development on inequality is large and stronger for countries with greater financial development (as measured by more private credit). Arguably, working in the modern sector requires more access to finance, e.g. to start and run a firm, or to invest in higher education.

In terms of undernourishment, one is considered undernourished when one's food intake falls below the minimum requirement or when one's food intake is insufficient to meet dietary energy requirements continuously. There are at least two channels through which financial development reduces prevalence of undernourishment through:

1. reduced income poverty; and
2. higher agricultural productivity.

Higher income enables households to avail themselves of more and better nutrition. Higher agricultural productivity enables rural households to increase the yields of their land for their own consumption or sell and trade the surplus, boosting their incomes. Moreover, higher productivity can lower the market price of food, thereby making it more accessible to poor households. The poor typically lack income and access to healthy nutrition, which may lead to undernourishment, an important component of the Poverty MDGs. Since financial development reduces income poverty and since there exists a strong relationship between income poverty and undernourishment, financial development may reduce the prevalence of undernourishment via income poverty reduction.

Also, it is expected that undernourishment influences agricultural productivity and vice versa. This is because of the causal relationship between financial development and the growth of agricultural productivity. In turn, this is associated with less undernourishment. Arguably, greater availability of credit enables farmers to invest in productivity enhancing equipment and techniques like irrigation, fertilizers, and tractors. Indeed, preliminary analyses suggest a strong association (sometimes even causal) between financial sector development and several agricultural productivity variables.

III.5 Financial Services and Health

a) Access to insurance, credit, and savings gives access to better health care treatment and living and working conditions

Health care expenses can be high and often come unexpected. They are often induced by lack of past health care treatment and poor living and working conditions. Health care insurance enables households to take precautionary health care measures and treat illness and disease more effectively. Moreover, financial services enable households to invest in better living and working conditions (i.e. better housing and safer working equipment), reducing the probability of accidents and hygiene-related diseases. In addition, financial services are able to help households struck by diseases to keep their income streams relatively stable.

b) Financial services may improve education, which is beneficial for future household health

Previously, we discussed that financial services could improve access to education and enhance the gains from schooling. In turn, we can expect that financial services development will influence the health of future households via better education of their children.

c) Financial services may empower women leading to better household health care

Women take better care of their children and spend more of their household budget on improving household welfare than men do. Hence, financial services that empower women would indirectly contribute to better household health conditions.

d) Financial development induces economic growth and facilitates public and private investment in health care infrastructure

Higher economic standards and growth are associated with better and more health services, e.g. more hospitals and clinics. Since financial development spurs economic growth, facilitating more investment, it can lead to a better health care system.

III.6 Financial Services and Education

a) Access to credit and savings to pay for schooling expenses

When household income is low, households cannot afford educational services, although education is clearly a good investment otherwise. Income may be structurally low or could be temporarily low due to shocks, as in the case of droughts. As a consequence, children may not enroll or drop out of school prematurely during such hard times. With better functioning financial markets, households may be able to borrow against future income to pay for tuition fees, school uniforms, and transportation costs, even when current income is low.

b) Child labour substitutes for a lack of agricultural insurance

Child labour in Nigeria is used as insurance against unexpected seasonal fluctuations in the income of agrarian households. As a consequence, school attendance is lower in these periods. Assuming that education has positive returns, this self-insurance mechanism may be detrimental to households in the long-run. Again, financial markets can help overcome this problem.

c) Financial services may empower women, which leads to better education of children

We already stated that women take better care of their children and spend more of the household budget on improving household welfare, including through education, than do men. Hence, financial services that empower women can indirectly contribute to better education of their children.

d) Financial services may increase school returns by better health care and less undernourishment

Financial services in the form of credit, savings, and health insurance can prevent common diseases by making precautionary doctor visits and immunization possible. In addition, financial services can enable households to pay for better health treatment and medicines. In turn, financial services may boost educational performance via health improvements.

e) Financial development induces economic growth that leads to greater public and private investment in educational infrastructure

Higher economic standards and growth are associated with better and more schools. Since we earlier argued that financial services development spurs economic growth, it can indirectly contribute to a better educational system.

III.7 Financial Services and Gender Equality

We hypothesize that financial services mainly benefit gender equality through boosting female income generating activities.

a) Finance can contribute to general female independence

Access to financial services enables women to take their destiny more in their own hands and be more productive. Using financial services, they can manage their own income and can borrow money for entrepreneurial activities without being (as) dependent on their husbands or middlemen.

b) Better financial services may lead to better future education of women who consequently are better and able to take control of their lives

Greater current availability of financial resources to send more girls to school can produce a future generation of literate, better-educated women who are better and able to take control of their lives.

c) Financial services targeted at women's special health care needs may empower them

Credit, savings, and insurance may enable women to access basic women-specific health care, like hospitalisation during child birth.

IV. Financial Services and the Poor in Nigeria

Despite the developmental functions of the CBN from inception and the various initiatives put in place by the financial regulatory agency overtime, poorer households and smaller firms still lack usage and access to financial services. This result, then, raises the following questions:

- Exactly how many poorer households and smaller firms lack access to financial services in Nigeria?; and
- What are the barriers for them to get (better) access to financial services?

Answers to these questions would require understanding of both what drives financial sector development and what determines the access to finance by individual households and firms. The answers relate to the fact that the existing financial development and outreaches are yet to efficiently and effectively provide a broad range of affordable financial services to all. Consequently, poorer households and smaller firms have lower usage of, and experience higher barriers to access financial services. While much is known about what drives financial sector development in general, it is less clear how to enhance access for the poor and how effectively to create a level playing field for smaller firms relative to their larger counterparts. As a consequence, the potential impact of financial sector development on the MDGs remains largely untapped and it and doubtful whether the year 2015 targets for the achievement of the MDGs would be realistic in the economy.

Evidences from the recent banking consolidation and the crisis that occurred in some of Nigeria's banks revealed that the financial sector had hitherto functioned ineffectively and inefficiently. They were not well developed and poor outreach to clients. This manifested itself in small banks; shallow stock markets; rudimentary insurance markets; low usage of loans, deposits, and insurance products; and poorly developed bank networks and other distributions channels. The result is that financial services are out of reach for poor households and smaller firms in spite of the efforts of the CBN.

Outreach to households of the financial services is significantly low in the country and the implications of this development affect the poor more. Up till now, there is still a general limited use of, and access to, financial services. More specifically, the economy has lower penetration of banking branches and ATMs, and a lower usage of deposits, loans, and insurance policies. Despite improvements, the microfinance industry still lacks scale and stability to compensate for this lack of financial services in developing countries.

Some of the differences in the usage of formal banking services may reflect the more widespread usage of informal financial services in the country. Even the microfinance programmes, which are especially targeted at providing services towards the poorest in the country also, have a relatively low penetration rate in the economy. Low usage of financial services by SMEs does not necessarily mean low demand of smaller firms for external financing. Rather, there is much evidence that SMEs are credit-constrained, that is, they have an unmet demand for external financing. Thus, poor households and smaller firms typically have lower usage of, and lack of access to financial services. They are not well able to raise affordable external financing, and are compelled to finance their investment more internally with extra costs and risks. As a consequence, poor households and smaller firms are not able to fully participate in the economy and accumulate enough capital (in terms of assets, education, and health) to improve their living standards, resulting in underinvestment in many ways, leading to worse MDG outcomes.

IV.1 General Reasons for non-use/Lack of Access of Financial Services by the Poor

Why do poor households and smaller firms have lower access to, and usage of, financial services? The starting point for answering the question is differentiating between *access to* and *usage of* financial services. Usage is the actual consumption of financial services, whereas access is the availability of the supply of financial services at a reasonable cost. Hence, there can be a difference between access and usage. When a household or firm does not use financial services, it might have access, but chooses not to use it; or it may not have access and, consequently, is not able to use it.

The reasons for not using financial services are multiple. Many households in Nigeria choose not to have a bank account, as they write no cheques, collect their wages in cash, and transact their finances in cash. So, while they likely have access, they may not be burdened by lack of use. Firms that do not use external credit may choose not to do so because their rates of return on capital are too low to justify formal finance or because they are not willing to provide the necessary information about their business to banks and by implication to others, including the tax authorities. Equally important is the fact that financial service providers may not wish to supply financial services to all customers since it is not profitable or sustainable to do so. This does not reflect any market failures, but rather indicates that finance, like other services, has its own demand and supply forces.

Macroeconomic instability, a weak institutional environment, large government intervention, and lack of competition can act as barriers to accessing financial services or, even when accessible, make financial services more expensive. First, high inflation and large systemic risks make financial intermediation more difficult. In terms of credit, such risks decrease the probability of repayment of otherwise viable investment opportunities, making lenders more reluctant to lend. This relationship can be exacerbated by institutional weaknesses such as a poor legal system, absence of credit information, and poor collateral registration. As a consequence, the financial sector can remain small and access more limited.

Secondly**,** government policies such as interest rate ceilings, targeted lending, or subsidised credit programme often distort access, could impede proper pricing, and reduce the interests of financial institutions to innovate and offer new financial products. In general, these interventions can twist good economic decision-making. They can remove incentives for banks to attract deposits, and make good loans. They could also reduce the willingness of depositors to put money in banks and make borrowers to exert enough effort and pay back. Moreover, while some of these government interventions are designed to increase access to financial services for the underserved households and firms, reality often entails that only the well-connected are offered this preferential access. Therefore, the effects may be perverse; rather, the ones with the best investment opportunities are crowded out**.**

Thirdly, a lack of competition makes financial institutions less interested in providing basic services. It often results in banks targeting only the more affluent consumers and the large corporations that provide higher margins. With more competition, financial institutions are more inclined to go downstream to look for profitable growth opportunities. Particularly, foreign banks entry has proven to be beneficial to enhance competition. Besides intensifying competition, foreign banks can also bring in more sophisticated technology, systems, and people.

IV.2 Market Forces Issues

IV.2.1 Supply Side Problems

a) Information problems.

Often, suppliers of credit or insurance companies cannot obtain enough information about the investment opportunity that exist and the behavior of the borrower, making them reluctant to extend financing. This happens when there is no credit history of the potential borrower, when the cash flow calculations cannot be trusted due to weak accounting standards, or when the lender simply does not have the sophistication to assess the quality of the investment. Credit information is important for financial institutions to extend financing, especially to households and smaller firms. A lack of credit information may result in the rejection of otherwise good loans, as only crude characteristics such as income or region can be used.

Another related problem is that future income streams of the poor are harder to estimate and keep track of, whereas middle class salaries are often paid by established organisations and are more easily tracked. A reason for this is that poor people are often active in the informal economy and do not make bank transactions to avoid monitoring, including by the tax office. This situation results in a more costly way of transacting with the poor in the economy, which often means banks shying away from extending loans to the poor in the first place.

b) Transaction problems.

To be sustainable, and taking into account the costs associated, a loan, insurance policy, payments service, or a deposit account should be profitable for its provider. However, this is less likely in the case of small accounts or loan sizes: accepting a ₦100 deposit can cost as much as accepting one of ₦100,000. These transactions, however, cost money and involve high fixed costs, including the maintenance of a costly branching network. This is an important problem since the average deposit of a poor person can be as little as a few naira.

Furthermore, it may be more costly to provide financial services to poor people in the country as they often lack identity cards or birth certificates that are necessary to open an account, implying that other means will be needed to facilitate their access to financial services. When opening an account, high minimum deposit amounts or fees may be required to compensate for these costs. However, this requirement limits access to the richer segments of society in the country. Having to pass on costs could be a larger problem for financial institutions that operate on a relatively small scale or have to operate in areas with low population density, like some microfinance institutions in various parts of the country. By gaining size and economies of scale and using better cost management, unit cost could be lower, potentially leading to higher outreach and more attractive prospects for financial institutions.

c) Enforcement problems.

A good legal system and well-functioning courts could help with access. Ease of enforcement, for example, facilitates repayment of a loan. Conversely, in the absence of a good legal environment, lenders will be more hesitant to extend loans. Under such situation, poor people will be more affected by these legal and judicial deficiencies. They often lack documents to prove ownership of assets that can be used as collateral. Credit extended is accordingly less than normal for these reasons in the country. In some parts of the country, women are even worse off, since they are not allowed to hold assets at all. Providing collateral or co-financing does not just supply security, but also ameliorates information problems, since borrowers will behave more prudently when they may lose their own assets. However, poor households and SMEs typically do not have the necessary assets to begin with. Hence, banks often take refuge to crude personal and cultural characteristics, which often discriminate against the poor and small firms that could otherwise represent healthy businesses.

IV.3 Demand side Problems

a) Financial illiteracy

The poorest households in Nigerian economy are often illiterate and have limited understanding of the various products in the financial markets. For example, applying for a loan or an account may involve filling in several forms, which might be too challenging for many. As a result, the illiterates are less able to deal with the often high administrative burden of opening an account or applying for a loan.

b) Lack of Trust.

Lack of trust and safety may be the main reasons why some poor households remain unbanked. Partly driven by mistrust in the financial system, and for cultural reasons, many of them prefer to invest in low-yielding physical assets such as land, houses, cattles, among others. Households might mistrust banks for good reasons, especially after financial crisis, like the one that occurred in 1993 when many finance companies in Nigeria collapsed and many poor people were made worse off.

c) Informal Financial Services.

Many households and SMEs do not obtain financial services via the official financial system, but rely on other means in Nigeria like "Esusu". In addition informal remittances are often processed through informal networks or through money order transfer companies that operate outside the formal financial system in the country. Family, friends, and their internal savings are typically the first source for those in need of capital. This informal finance happens in both developed countries and developing countries, but more so, in financially less-developed countries.

V. Enhancing the Inclusion of the Poor in Nigerian Financial Service Activities

While Part II of this paper showed that financial development and access to financial services could help in achieving the MDGs in the country, Part III showed that many poor households and small firms in Nigeria still lack access. In this segment, enhancing access of financial services by the poor and small firms in the country would be addressed through the achievement of the MDGs in the country by 2015 under the following:

V.1 Expanding Scale of the Various Financial Institutions

Expansion of the size of the various financial institutions in the country is necessary because the fixed costs in financial intermediation make it hard for small institutions to provide services for small clients, especially in small markets. It is understood that economies of scale lead to decreasing unit costs as transaction volumes increase, making some specialisation attractive for increasing access. While the recent consolidation in the banking system and the various on-going restructuring initiatives have increased the strength of Nigerian banks, the proliferation in the number of microfinance institutions in the country has continued to make most of them inefficient. Greater size can be attained by, for example, having foreign banks enter into the domestic market and encouraging regionally operating banks to use a common infrastructure within ECOWAS Member States. The ECOWAS Common Investment Market (ECIM) is expected to address this issue. The CBN should take the lead in this area.

V.2 Use of Existing Public Networks

In addition to the existing banks and other financial institutions, there is a large network of other public institutions which are lying idle and could be used to extend financial services to the vulnerables. They include institutions such as postal offices as well as other government institutions that could be used to allow various financial institutions to offer electronic finance services, thus sharing the fixed costs of a large network.

V.3 Improve Credit Infrastructure

Analysis of the access of small firms and the poor households to financial services in the country suggests that the institutional environment matters, perhaps even more than for households. This is particularly so on the credit side. Small and medium firms in the country use less of external finance, especially less of trade finance yet finance from banks is a major tool for trade financing management. Trade finance becomes a high risk venture given the absence of certain key information to mitigate such risks. For instance, knowledge of a customer's indebtedness in each of his locations would be a valuable tool for the banks to assess the customer's standing with other banks before committing fresh funds. This problem could be solved through the establishment of more credit risk management database in the country.

With a password to access the web-enabled connectivity of such a data base; a bank approached for funds in the country can quickly verify a customer's indebtedness to other banks in the economy and quickly judge his/her standing and credibility in honouring obligations (Aremu and Bamba, 2011). It would minimise the incidence of credit risks on member banks. This is currently lacking and hindering access to financial services in Nigeria. The absence of credit information, difficulty in registering and recovering collateral, and problems with contract design and property rights enforcement could make lending, especially difficult. Credit services may, consequently, be limited to entrepreneurs with credit history, immovable collateral, such as real estate, or (political) connections, even if the entrepreneur has an otherwise sound investment opportunity. Under the ECIM project, ECOWAS Commission is working on similar areas on a regional basis.

In Nigeria, the current licensing of credit bureau may be able to bridge these identified gaps with the right regulatory frameworks to compel banks and other credit granting institutions to use the services of these credit bureaux.

V.4 Adjust Regulations Interfering with Operations

It is acceptable for CBN to regulate financial services provision, but sometimes such interference, if not properly packaged or implemented, may negatively affect efficient provision of financial services. For instance, some regulations can discourage the emergence of financial institutions that are more suited to the needs of lower-income households or smaller firms. It is the duty of the CBN, through its Corporate Communications Department to collate some of these regulations that generate backlash effects on the economy and make necessary adjustments. Rigidity in chartering rules, high minimum capital adequacy requirements, restrictions on funding structures, excessive regulation and supervision, and overly strict accounting requirements and other rules can prevent the emergence of microfinance institutions and smaller financial institutions aimed at providing access to financial services to the poor and small firms.

V.5 Adapt Regulation to Facilitate Multiple Forms of Financial Services

In Nigeria, many households patronise the banks for savings their money and making payments services. The attention of monetary authority should be focused on this area as opposed to excessive concentration on credit services. Hence, in its regulation, the CBN may need to consider savings mobilisation separately from credit extension. These types of financial services provision may require different forms of regulation and supervision.

V.6 Establishment of Financial Literacy Programmes

The general level of financial literacy in Nigeria is still relatively low, and may need to be increased, as is actively being done in other countries. Many people still prefer cash transactions to other easier modes of payments that are less expensive even to the banks. Consideration needs to be given to educating people on the benefits of (new) financial services architecture, which the CBN is putting in place and different types of financial service providers, so that people can strike the right balance between risk and benefits.

V.7 Enforce Regulations

It is understood that the various regulations from the CBN are aimed at protecting savers and borrowers against misuse and risks, though it might not be effective in some areas, given the lack of appropriate supervisory capacity, independence, and effective checks and balances, and may end up impeding access. A balance will need to be found between rules and enforcement capacity, with more emphasis given to market forces when enforcement is weak.

V.8 Providing Equal Access to the Financial Infrastructure

Smaller and non-bank financial institutions have often limited access to existing networks. In Nigeria the activities of the Nigerian Payments and Settlement System (NIPSS) are limited to a club of large banks. Consequently, important financial information-sharing is restricted to these banks and formal financial institutions. These developments, together with the limited existence of (private) credit bureaux make it difficult for other financial institutions to provide financial services, especially to low-income households and small firms. Yet, lower-income people often get their credit from these non-financial institutions. NIPSS activities should be expanded to cover these left behind institutions.

V.9 Permitting more Foreign Banks

In addition to the general view that competition can help with access, entry by foreign banks can enhance access. The presence of more foreign banks on the domestic banking system would compel local banks to lend to smaller firms, and direct provision of financial services by foreign banks. In addition, more foreign banks' entry would have indirect effects on the overall banking system, such as greater financial stability and improved efficiency of financial intermediation. These two effects can make the Nigerian banking environment more conducive to lending, including particularly lower-income segments, and could put pressures on local banks to engage more in lending to lower-income segments as profitability in other segments declines.

V.10 Broader Access to Financial Services as Public Goods

For services deemed to be essential (i.e public goods), such as access to clean water, education, and healthcare, it is customary for governments to often intervene and either provide these services themselves, provide subsidies or require the traditional providers to extend their services to all in society, or at least to many, even if the private costs exceed the private returns (for social benefit reasons). These universal access objectives, however, are generally not found in financial services. Yet the MDGs appear to be related to public goods objectives. To determine whether there is a case for universal provision of financial services, more needs to be known about: the benefits of access to finance: why households and firms demand (or do not) financial services; why financial service providers provide (or do not provide) financial services; the costs to society of providing greater access; and what the role of CBN should be.

V.11 Design Financial Products more Suitable and Cheaper to the Customers

Banks and other financial institutions in Nigeria can also improve access to their services through better innovation to make their products more suited to low-income households and small firms. Mostly, this drive for innovation will occur through competitive forces. The sharp drop in the costs of international remittances over the last few years, for example, is due largely to competition. But, there have also been large effects of the improvements in technologies, both in terms of financial engineering and information and communications technology, driving innovations and lowering costs. Emerging observations suggest that there is still ample room for financial institutions to improve access for other forms of financial services, including through the use of new technology. The CBN is encouraged to cooperate with ECOWAS Commission in the implementation of the Regional Payments System of the Community under ECOWAS Common Investment Market (ECIM) initiative.

V.12 Encourage Use of Improved Technology to Reach Customers

New technology, including the internet, smart cards, and the use of mobile phones, can help to broaden access. The country can benefit from the increasingly wide coverage of cell-phone networks by the CBN advising the banks to go mobile. This is the logic behind the recent CBN initiative of mobile banking in Nigeria. Mobile phones can be used for financial services provision. Since mobile phones are often more widespread in Nigeria and have a lower threshold for many users than banks do, mobile phones have already facilitated access for low-income households in developing countries. Such hand-held remote transaction tools can be used by several microfinance institutions in the country to process on-the-spot loan applications and approvals.

V.13 CBN can Facilitate Introduction of new Financial Products

It is not compulsory for new products in financial services to come through competition and market forces alone, but also through CBN product intervention and public opinion like the one described above. In South Africa in 2004, for example, the country's four big retail banks along with the post office's Postbank launched the Mzansi Account, a low-cost bank account aimed at extending banking services to the black majority (Napier, 2005). Under the initiative, an account holder requires a minimum deposit of 20 rand (about US$4) to commence operation. The opportunity was aimed at providing access to financial services to some 13 million low-income South Africans without prior access to bank accounts. This sort of initiative can be introduced into the Nigerian economy also.

V.14 CBN to Engage in more Research on Access to Finance

With three (3) more years to the end of MDGs target, the CBN needs to conduct further analyses of the success of different models aimed at enhancing access and use of financial services to better the life of the vulnerable on:

- How to enhance the access of the vulnerable groups to financial services;
- The benefits of access of the small firms and the poor to financial services;
- The means of intervening in the financial system to enhance access and use of the various products in the financial markets;
- The political economy factors affecting the access and use of financial services by the poor in Nigerian economy;
- The effects of having/or not having access and not using the services in the financial market; and
- Other ways to stimulate access and use of financial services towards meeting the MDGs targets; and

- The causal relationships between access to finance and various MDG targets as well as financial sector development models and poverty reduction.

VI. Conclusion

At the turn of the century, the world economy was dynamic and a consensus was being formed to find ways to share the benefits of globalisation more broadly. In 2000, therefore, the world agreed on the MDGs, an ambitious set of development targets aimed at reducing poverty and improving the lives of those people living in poverty globally. Countries, large and small, committed to meeting these targets by 2015. This year, 2012, is the defining moment for keeping this global promise, but to do so, countries must accelerate efforts toward meeting the MDGs by the target date. Without doubt, the MDGs would not be achieved in Nigeria if efforts across the board are not accelerated. Strengthened with knowledge and evidence gathered over the past eleven years, Nigeria must seize the opportunity to revitalise the push toward creating an economy that was envisioned for 2015: one that is healthier; better educated; better nourished; and has taken significant steps toward eradicating extreme poverty.

Explanations from this paper revealed that financial sector development can make an important contribution to economic growth and poverty reduction. This is especially likely to be true in Nigeria, whose financial sectors is still developing, and without which economic development of the country as well as achievement of the MDGs may be constrained, even if other necessary conditions are met. It was discovered that the poor in the country, who are the target for the achievement of the MDGs often do not have access to ongoing, formal financial services, and are forced to rely instead on a narrow range of often risky and expensive, informal services. This constrains their ability to participate fully in markets, to increase their incomes and to contribute to economic growth. Thus, formal and semi-formal financial services channels, as mentioned in this paper, could provide inclusion opportunities to the poor (the target group in the MDGs) in Nigeria.

By increasing the savings rate and the availability of savings for investment, facilitating and encouraging inflows of foreign capital, and optimising the allocation of capital between competing uses, further financial sector development and its inclusion of the poor, as presented in Part IV of this paper in the country can boost long-run growth of the economy as well as the fulfilment of MDGs. Though the scale may be different, access of the vulnerable groups to financial services in the country could reduce poverty through the same channels that affect overall growth: by increasing investment and productivity resulting in greater income generation; and facilitating risk management, thus, reducing vulnerability to shocks.

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Appendix

Indicators of the MDGs

Goal 1: Eradicate extreme poverty and hunger

Target 1a: Reduce by half the proportion of people living on less than a dollar a day

- 1.1 Proportion of population below $1 (PPP) per day
- 1.2 Poverty gap ratio
- 1.3 Share of poorest quintile in national consumption

Target 1b: Achieve full and productive employment and decent work for all, including women and young people

- 1.4 Growth rate of GDP per person employed
- 1.5 Employment-to-population ratio
- 1.6 Proportion of employed people living below $1 (PPP) per day
- 1.7 Proportion of own-account and contributing family workers in total employment

Target 1c: Reduce by half the proportion of people who suffer from hunger

- 1.8 Prevalence of underweight children under-five years of age
- 1.9 Proportion of population below minimum level of dietary energy consumption

Goal 2: Achieve universal primary education

Target 2a: Ensure that all boys and girls complete a full course of primary schooling

- 2.1 Net enrolment ratio in primary education
- 2.2 Proportion of pupils starting grade 1 who reach last grade of primary
- 2.3 Literacy rate of 15-24 year-olds, women and men

Goal 3: Promote gender equality and empower Women

Target 3a: Eliminate gender disparity in primary and secondary education

preferably by 2005, and at all levels by 2015

- 3.1 Ratios of girls to boys in primary, secondary and tertiary education
- 3.2 Share of women in wage employment in the non-agricultural sector
- 3.3 Proportion of seats held by women in national parliament

Goal 4: Reduce child mortality
Target 4a: Reduce by two thirds the mortality rate among children under five

- 4.1 Under-five mortality rate
- 4.2 Infant mortality rate
- 4.3 Proportion of 1 year-old children immunized against measles

Goal 5: Improve maternal health
Target 5a: Reduce by three quarters the maternal mortality ratio

- 5.1 Maternal mortality ratio
- 5.2 Proportion of births attended by skilled health personnel

Target 5b: Achieve, by 2015, universal access to reproductive health

- 5.3 Contraceptive prevalence rate
- 5.4 Adolescent birth rate
- 5.5 Antenatal care coverage (at least one visit and at least four visits)
- 5.6 Unmet need for family planning

Goal 6: Combat HIV/AIDS, malaria and other diseases
Target 6a: Halt and begin to reverse the spread of HIV/AIDS

- 6.1 HIV prevalence among population aged 15-24 years

- 6.2 Condom use at last high-risk sex
- 6.3 Proportion of population aged 15-24 years with comprehensive correct knowledge of HIV/AIDS
- 6.4 Ratio of school attendance of orphans to school attendance of non-orphans aged 10-14 years

Target 6b: Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it

- 6.5 Proportion of population with advanced HIV infection with access to antiretroviral drugs

Target 6c: Halt and begin to reverse the incidence of malaria and other major diseases

- 6.6 Incidence and death rates associated with malaria
- 6.7 Proportion of children under 5 sleeping under insecticide-treated bednets
- 6.8 Proportion of children under 5 with fever who are treated with appropriate anti-malarial drugs
- 6.9 Incidence, prevalence and death rates associated with tuberculosis
- 6.10 Proportion of tuberculosis cases detected and cured under directly observed treatment short course

Goal 7: Ensure environmental Sustainability

Target 7a: Integrate the principles of sustainable development into country policies and programmes; reverse loss of environmental resources

Target 7b: Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss

Target 7a and 7b Indicators:

- 7.1 Proportion of land area covered by forest
- 7.2 CO_2 emissions, total, per capita and per $1 GDP (PPP)
- 7.3 Consumption of ozone-depleting substances
- 7.4 Proportion of fish stocks within safe biological limits
- 7.5 Proportion of total water resources used
- 7.6 Proportion of terrestrial and marine areas protected
- 7.7 Proportion of species threatened with extinction

Target 7c: Reduce by half the proportion of people without sustainable access to safe drinking water and basic sanitation

- 7.8 Proportion of population using an improved drinking water source
  7.9 Proportion of population using an improved sanitation facility

Target 7d: Achieve significant improvement in lives of at least 100 million slum dwellers, by 2020

- 7.10 Proportion of urban population living in slums

Goal 8: A global partnership for development

Target 8a: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system

Includes a commitment to good governance, development and poverty reduction; both nationally and internationally

Target 8b: Address the special needs of the least developed countries
Includes tariff and quota free access for the least developed countries' exports; enhanced programme of debt relief for heavily indebted poor countries (HIPC) and cancellation of official bilateral debt; and more generous ODA for countries committed to poverty reduction

Target 8c: Address the special needs of landlocked developing countries and small island developing States through the Programme of Action for the Sustainable Development of Small Island Developing States and the outcome of the twenty-second special session of the General Assembly

Target 8d: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term

Finance for Growth and Policy Options for Emerging and Developing Economies: Nigeria

*Wumi Olayiwola, Henry Okodua and Evans S. Osabuohien**

I. Introduction

Finance involves the transfer of funds in exchange for goods, services, or promises of future return. It involves the bundle of institutions that make up an economy's financial system performing key economic functions such as:

- Mobilising savings;
- Allocating capital (notably to finance productive investment);
- Monitoring managers (so that the funds allocated are spent judiciously) and
- Transforming risk (reducing it through aggregation and enabling it to be carried by those willing to bear it).

There is no gain-saying on the fact that finance is important for economic growth, but the role of finance in economic growth is a controversial issue in the economic literature. Lucas (1988) dismisses finance as an "over-stressed" determinant of economic growth. Robinson (1952) argued that "where enterprise leads, finance follows". From this perspective, finance does not cause growth, finance responds to the changing demand from the real sector. But, Grossman and Miller (1988) argued that "the idea that financial markets contribute to economic growth is a proposition too obvious for serious discussion". The focus of this paper is not to join the debate, nor to analyze the impact of financial development on economic growth, but to discuss the concept of "finance for growth" within the context of emerging and developing economies.

The concept of "finance for growth" refocuses the relationship between finance and economic growth by redirecting the role of government policies in finance, and recognises how finance without frontiers is changing what government policies can do and achieve. It articulates importance of legal and information base, private sector monitoring of financial sector, cost of state ownership of

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banks, benefits of foreign banking; and how technology is leading to finance without frontiers. The concept does support policy positions of "leaving finance to the market", "privatise the banks"; "open-up to entry of foreign financial firms and capital, but not without robust regulatory system (Caprio and Honohan, 2001; Prasad, Rajan, and Subramanian, 2007).

The increasing development needs of Emerging Market Economy (EME) to raise per capita income, reduce unemployment rate, construct and maintain basic infrastructure, and invest more in human capital, etc make the role of finance for growth in these economies indispensible. The EME is loosely defined to include all countries that had embarked on economic development and reform programmes, and also opened up their markets and "emerge" onto the global trading arena. The major feature of EME is the presence of vast resources (especially human and natural) that usually attract investment from foreign investors. The focus on EME is mainly due to their economic growth and the flexibility of the policies that encourages foreign investments. Typical emerging countries include Brazil, Russia, India, Indonesia, China, and South Africa (BRIICS).
Nigeria and most other Sub-Saharan African (SSA) countries are regarded by the Vital Wave Consulting as EMEs with long-term opportunity markets. The essential characterization of this category is that they are currently the least attractive markets to multinational corporations. In addition, their economies exhibit a low standard of living with a Gross National Income (GNI) per capita under $2,000 per year in Purchasing Power Parity (PPP) terms. Moreover, there is persistent poverty, corruption and political instability in these countries and these factors inhibit economic growth. However, given consistent political and economic reforms, the long-term market opportunities make their economies very viable markets for substantial foreign investment in the long-term.

There are two broad policy options that are open to EMEs to guarantee and achieve finance for growth. There is the option of domestic resource mobilization (DRM) and the other is foreign capital inflow. DRM entails the generation of savings from domestic sources and their allocation to productive investment involving public and private sectors (Quartey, 2005; Culpeper, 2008; Aryeetey, 2009). The public sector can use taxes, royalties, fines and levies, borrowing (internal and external), among others, to garner the needed financial resources. The private sector on the other hand can rely on savings from households, firms and the public to mobilise resources. In support of DRM, Culpeper (2008) argued that DRM is desirable as it can engender meaningful development, and also it may be difficult to realise development from dependence on external financial flows. However, Henri-Bernard (2010) noted that the major challenge with DRM sources from the public sector is that they are mostly based on revenues from natural resources, which are not only depleted over time but are also highly susceptible to shocks at the world market. Other factors that explain the low level of DRM include weak political governance, poor institutional quality, ethnic-religious crises, weak financial intermediation, poor insurance against adverse shocks, among others (Fosu, 2008; Olayiwola and Osabuohien, 2010).

Foreign finance inflow on the other hand, comes largely in the form of portfolio investment, foreign direct investment (FDI), grants and aid, remittances, among others. Foreign financial flow is needed to fill the resource gap in capital flows hence, it is equally essential for economic development in EMEs. However, this source is not without its constraints such as the existence of limited information flow on the sovereign risks and investment opportunities in the developing countries, and long gestation period for social/infrastructural investments (Baliamoune and Chowdhury, 2003; Aizenman, Pinto, and Radziwill, 2007). The challenge seems to have heightened as a result of the global financial crisis that led to a reduction in the volume of remittances inflow, official development assistance (ODA), FDI, among others, in most developing countries especially those in SSA (Africa Economic Outlook, 2010). In spite of these challenges, a growing financial sector in an economy open to international trade cannot always be insulated from cross-border financial flows (Obstfeld, 2008). EMEs may rely on a mix of the two policy options in sourcing finance for growth as it will be impracticable to depend entirely on one source.

In formulating policies to guarantee finance for growth, there will always be the need for policymakers in EMEs, especially Nigeria, to address the following issues: what are the major impediments to mobilising investment funds?; and what are the appropriate policies for achieving and guaranteeing finance for growth?. This paper attempts to address these issues by assessing the performance of financial policies of selected EMEs in mobilising financial resources for economic growth, and identifying policy options necessary for achieving finance for growth. The rest of the paper is organised as follows. Section 2 discusses the basic characteristics of emerging economies (EMEs), and Section 3 positions Nigeria among the EMEs within the context of finance for growth. Section 4 deals with challenges and constraints of Nigeria in achieving finance for growth, and Section 5 provides possible policy options and conclusion.

II. Characteristics of an Emerging Market Economy (EME)

The origin of the term EME is credited to Antoine W. Van Agtmael of the International Finance Corporation of the World Bank who coined it in 1981. The basic characteristics of EME as documented in the literature are as follows:

Economic Growth

Emerging economies exhibit high economic growth coupled with per capita income and rapid integration into world market. There is the presence of vast resources (especially human and natural) that usually attract investment from foreign investors. They have visible economic growth and policies that encourage foreign investments. Typical emerging countries include Brazil, Russia, India, Indonesia, China, and South Africa (BRIICS). Some of these countries also have high economic performance, rapid integration into the world market, relative political stability, friendly business environment and policy level decision governing future growth directions.

Economic Reforms

As an emerging market, the country is embarking on an economic reform programme that makes it stronger and more responsive economy. It also exhibits transparency and efficiency in the capital market. EMEs also reform their exchange rate system because a stable local currency builds confidence in an economy, especially when foreigners are considering investing. Exchange rate reforms also reduce the desire for local investors to send their capital abroad (capital flight). Besides implementing reforms, an EME is also most likely receiving aid and grants from large donor countries and/or world organizations such as the World Bank and the International Monetary Fund (IMF).

Increase in FDI

Another key characteristic is increase in both domestic and foreign investment. A growth in investment indicates that the country has been able to build confidence in the domestic economy. Moreover, foreign investment is a signal that the world has begun to take notice of the emerging market. When international capital flows are directed toward an EME, the injection of foreign currency into the local economy adds volume to the country's stock market and long-term investment to the infrastructure. For foreign investors or developed-economy businesses, an EME provides an outlet for expansion by serving, for example, as a new haven for a new factory or for new sources of revenue. For the recipient country, employment levels rise, labour and managerial skills become more refined, and a sharing and transfer of technology occurs. In the long-run, the EME's overall production levels rise, increasing its GDP and eventually reducing the gap between the emerged and emerging worlds.

Portfolio Investment and Risks

EME offer an opportunity to investors who are looking to add some risk to their portfolios. The risk of an EME investment is higher than an investment in a developed market, and panic, speculation and knee-jerk reactions are also more common. A typical example was the 1997 Asian crisis, during which international portfolio flows into these countries actually began to reverse. Also, there was the issue of “the bigger the risk, the bigger the reward”. For example, foreign investors in Nigerian quoted companies earned about ₦38.3 billion in 2010. Nigerian business operations continued to provide attractive returns in spite of operating challenges. The Nation Newspaper Market Intelligence Report indicates that about 55 per cent of cash dividends declared by multinationals and other companies with substantial foreign shareholdings were repatriated as cash dividends to the foreign parent companies. The gross dividend represented about 20 per cent of ₦32 billion earned by foreign investors in 2009.

Regional Leaders

These EME countries are regional leaders who are at the forefront of the industrialisation and development stages in their regions. This makes them political heavy weights, who determine the course of the region through their own policies. Also, these countries are at the verge of change and this makes them a highly dynamic market, having varying and fractious groups of consumers driving growth. Their socio-political situation is poised to change making their policy changes very vital as well as very nimble. They enjoy increasing clout at the global stage as future leaders who were having the muscle to shape global policies and reduce the clout of the developed nations.

There is the role that these emerging economies play in the overall development of the entire region. These countries such as China, Nigeria and South Africa play a crucial role in the rise to prominence of the entire sub-continent in world politics and policy decisions. This added burden or responsibility governs their moves and brings out an added dimension of constraints on their actions and the policies they make both internally and externally while charting their growth paths.

III. Positioning Nigeria among the EME within the context of Finance for Growth

Within the concept of finance for growth, financial system must positively influence savings and investment before it will lead to economic growth. The system must perform five major functions:

- mobilize and pool savings;
- monitor investments and exert corporate governance after providing finance;
- facilitate the trading, diversification and management of risk;
- produce ex ante information about possible investments and allocate capital; and
- ease exchange of goods and services.

In order to position Nigeria among the EMEs in performing the financial functions, the brief description of financial policies of China, South Africa and Nigeria is followed by a comparative account of the rates of economic growth and other selected financial variables. Nigeria with population of more than 150 million has the largest economy with GDP which is larger than the remaining countries of the ECOWAS region. South Africa is a dominant economy of the SACU region, and China remains the emerging economic power in the world. Therefore, the patterns of movement of relevant variables to infer about their implications for economic growth were examined.

(a) A Review of Financial Policies in China, South Africa and Nigeria

CHINA

The abandonment of the single–banking system in 1979 marked the beginning of China's financial reforms. The Agriculture Bank of China, the People's Construction Bank of China and the Bank of China were carved out from the People's Bank of China, which formally became the country's Central Bank. Each of these three specialised banks was to provide services to a designated sector of the economy, and the Industrial and Commercial Bank of China was created in 1984. According to China Banking Regulatory Commission (CBRC), the total asset of China banking industry was US$5.45 trillion in 2006. The banking sector is heavily concentrated around the big four State-Owned Banks (SOBs) which represent 60-70 per cent of the domestic banking business. There were also 120 commercial banks, whose equity ownership is distributed among state and private investors. Credit cooperatives had 5 per cent of domestic banking business, and foreign banks accounted for only 2 per cent of total banking sector assets. The non-bank financial institutions accounted for 1 per cent of total banking assets.

In 1985, the restrictions limiting each SOBs to its own designated sector were lifted and the four banks were allowed to compete with each other in providing loans and deposit services. Competition remained limited until the mid-1990s as the banks continued to serve as "policy lending conduits" for the government, and lacking the requisite autonomy to compete (Wong and Wong, 2001). The central bank law and the commercial bank law in 1995 further deepened China's financial reforms. It allowed the SOBs to concentrate on commercially-oriented lending and emphasised the need for financial institutions to incorporate commercial criteria into their lending practices. Both laws lay the basis for building a modern banking system in China. A number of non-state owned banks entered the financial system, and licenses were granted to foreign banks. There was reduction in government intervention in credit allocation, interest rate control was loosened, and standard accounting and prudential norms were recorded (Shirai, 2002). The financial reform programme also rehabilitated the balance sheet of four largest SOBs, as large scale non-performing loans (NPL) in China banking sector continued to impede the development of financial intermediaries. These problems were partly addressed by the four Asset Management Corporations established in 1999 with the objective of taking over a large fraction of NPL and bad debts from the SOBs. A further impulse for changes in the banking sector in China came in to play with China entry into the WTO in 2001.

China emerging capital markets also experienced significant developments. In early 1990s, Shangai and Shenzhen Stock Exchanges were established. There was enactment and implementation of the Securities Law in 1999. This Law provides detailed rules and legal basis to regulate the investors and the listed companies. China stock market has played important roles by facilitating capital raising, promoting domestic investment and improving efficiency of financial resource allocation. There were rapid developments in China's bond market, money market, foreign exchange market and other aspects of financial sector.

SOUTH AFRICA

South Africa is Africa's biggest economy and has embarked on wide-ranging financial reforms both in the banking sector and stock market system. Commercial banks in South Africa are the dominant segment of the financial sector with assets of about 120 per cent of GDP. The four biggest banks- the Amalgamated Bank of South Africa (ABSA), First Rand Bank, Ned Bank, and Standard Bank- account for 85 per cent of the total assets and have an international presence in many countries. The South African financial sector is also open to foreign financial institutions.

Financial Services Board was established in 1994, with responsibility of effective supervision of non-banking financial institutions. In the same year, the first corporate governance rules were published by the King Commission and the National Payment Act of 1988 was introduced in order to bring South Africa financial settlement in line with international practice. Financial regulators and supervisors began to meet regularly and core principles of supervision of banks were developed and adopted. Application of capital-adequacy measures and effective management control system were increasingly accepted. South Africa has a sophisticated financial structure with a large and active stock exchange. The South African Reserve Bank (SARB) performs all central banking functions. The SARB is independent and operates in much the same way as Western central banks, influencing interest rates and controlling liquidity through its interest rates on funds provided to private sector banks. Quantitative credit controls and administrative control of deposit and lending rates have largely disappeared. South African banks adhere to the Bank of International Settlements core standards.

South Africa financial system was ranked 25th in the world in 2008 by World Economic Forum. The various reforms have led South Africa to be included in the major global stock market indices. The IMF (2008) confirms that South Africa is "fundamentally sound" with a good legal framework and sound financial infrastructure supported by prudent macroeconomic management. There is also an acknowledgement that the Johannesburg Stock Market is the fourth largest among the emerging markets and 17th in the world in terms of total market capitalization.

NIGERIA

In the 1970s, the Nigerian financial system was dominated by policies of financial repression and indigenisation. The repression policies included interest rate control, selective credit guidelines and fixed exchange rate regime. The indigenisation policy was directed at nationalising all foreign-owned banks in Nigeria. The adoption of Structural Adjustment Programme (SAP) in 1986 significantly influenced various indices of the Nigerian financial system such as interest rate structure, institutional development, reorganisation of money and capital markets operation, and non-deposit taking investment houses. There was deregulation of interest rates in 1987, and conditions for licensing new banks were relaxed which led to a phenomenal increase in the number of established banks in the country.

In 1988, the Nigerian Deposit Insurance Corporation (NDIC) was established with the aim of providing safety and boosting public confidence in the banking system. In 1992, government-owned banks were privatised with equity interest in eight (8) commercial banks and six (6) merchant banks were offered for sale. In July, 2004, the 13-point banking programme was enunciated, which included the requirement for Nigerian banks to increase their shareholders funds to a minimum of ₦25 billion (about 200 million US dollars) by the end of 2005; phased withdrawal of public sector funds; consolidation of banking institutions through merger and acquisition, and adoption of a risk-focused and rule-based regulatory framework. The consolidation of the banking industry, however, necessitated a review of the existing code for the Nigerian Banks. The 2006 Code of Corporate Governance for Banks in Nigeria Post Consolidation was developed to compliment other policies and enhance their effectiveness for the Nigerian banking industry. Compliance with the provisions of this Code was mandatory (Olayiwola, 2010).

At end-2009, the financial institution in Nigeria comprised the Central Bank of Nigeria (CBN), the NDIC, the Securities and Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission (PENCOM), 24 deposit money banks, five discount houses, 910 microfinance banks, 110 finance companies, 1,601 Bureaux-de-change, one (1) commodity exchange, 99 primary mortgage institutions, 5 development finance institutions and 73 insurance companies. In terms of social security fund, government introduced relevant programmes of which one of them is the mandatory individual accounts within the management of the National Pension Commission

(PENCOM). The programme covers all the federal public-sector employees including those in the military of which sources of funds are 7.5 per cent of gross salary for all employees/2.5 per cent of gross salary for military personnel.

In 1995, capital market was liberalised with the abrogation of laws that prevent foreign investors the same right, privileges and opportunities for investment in securities in the Nigerian capital market. The Central Security Clearing System (CSCS), which is the central depository for all the share certificates of quoted securities, commenced operations in April, 1997. The Investment Protection Fund (IPF) was approved, and NSE launched products like mortgage-backed securities, asset-backed securities, derivatives and exchange-traded funds in 2007.

In spite of all these reforms, there is what we can call "8 year cycle" of banking crises in Nigeria. These crises have eroded the confidence in the Nigerian banking sector to perform their statutory functions. The CBN has been involved in serious reforms of these banks through the replacement of the Chief Executive Officers/Executive Directors. Also, the apex bank injected the sum of ₦620 billion as liquidity support for these ailing banks. All these efforts were designed to ensure a diversified, strong and reliable banking sector, and to guarantee the safety of depositors' money. The reforms also aim at strengthening the Nigerian banking sector so that it can play active developmental roles and become competent and competitive players in both the African and global financial systems.

(b) Positioning Nigeria in the Context of Finance for Growth

A characteristic feature of the financial system of China, South Africa and Nigeria is the dominance of banking sector and capital market as the principal institutions of mobilizing savings and source of finance. The financial policies are very dynamic and they change in response to various domestic challenges and various developments at the global financial market. Until reforms were initiated in the late 1990s, there was the prevalence of administered domestic and lending interest rates and directed credit programme. All selected EME countries liberalised their financial market in order to provide opportunities for both domestic and foreign investors to actively participate in their market, which would in turn increases the level of liquidity, savings and growth of their economies.

To position Nigeria on "how well" its financial policy has performed with respect to financial functions, a comparison of economic growth and indicators of financial flows (covering both domestic and foreign) of these selected EMEs are conducted. For the domestic financial flow, we used the stock market capitalisation as percentage of GDP (*mk_gdp*) and bank credit to the private sector as percentage of GDP (*dcbank_gdp*). In terms of foreign financial flow, net foreign direct investment flow as percentage of GDP (*fdi_gdp*) and inflow of remittance as a percentage of GDP (*remit_gdp*) are used.

(I) Finance-Growth Nexus

In the period of 1990 to 1999, Nigeria and China witnessed positive economic growth, but South Africa recorded positive growth only in 1993 to 1999. While China economic growth increased from 3.8 per cent in 1990 to 7.6 per cent in 1999, Nigeria economic growth witnessed a decline from 8.2 per cent to 1.1 per cent during the same period. South Africa economic growth shows a similar pattern like that of China as the rate of economic growth moved from –0.3 per cent in 1990 to 2.4 per cent in 1999.

The period of 2000 to 2008 can be regarded as period of prosperity as all the selected countries witnessed positive economic growth. During this period, economic growth in Nigeria increased from 5.4 per cent in 2000 to 10.6 per cent in 2004 and 6.0 per cent in 2008. There were similar patterns in China and South Africa as their respective economic growth increased from 8.4 per cent and 4.1 per cent to 13.0 per cent and 5.1 per cent in 2007 (see Table 1).

Table 1: Economic Growth and Market Capitalisation (% of GDP) of Nigeria, China and South Africa

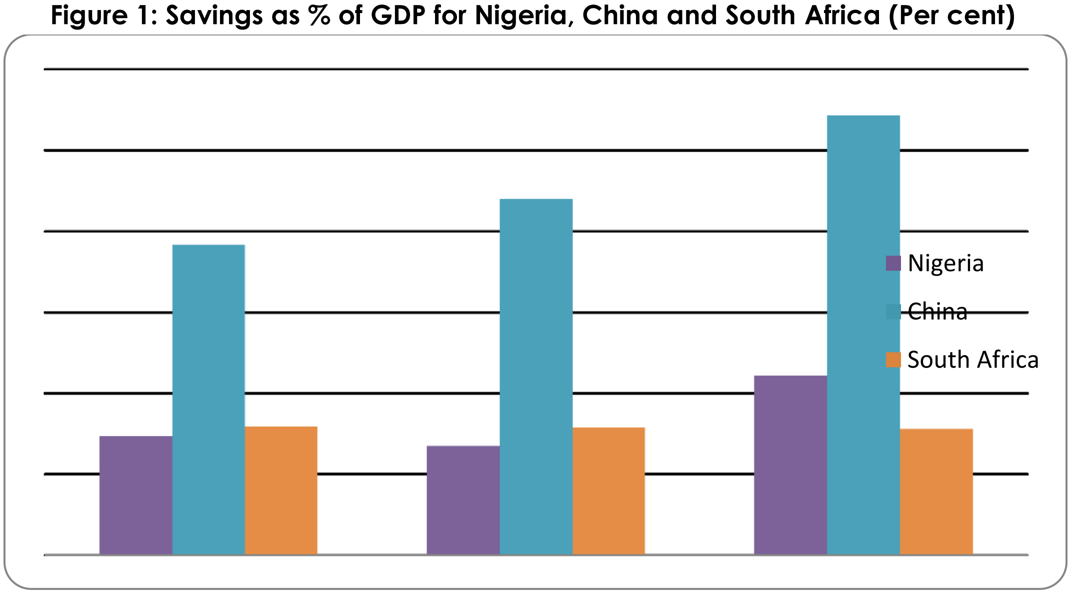
Year	Economic growth (%)			year	Market Capitalisation % GDP		
	Nigeria	China	South Africa		Nigeria	China	South Africa
1990	8.20	3.80	-0.32	1990	4.81	n.a.	123.20
1991	4.76	9.20	-1.02	1991	6.88	0.53	139.74
1992	2.92	14.20	-2.14	1992	3.73	4.33	79.69
1993	2.20	14.00	1.23	1993	4.82	9.22	131.90
1994	0.10	13.10	3.23	1994	11.45	7.78	166.45
1995	2.50	10.90	3.12	1995	7.23	5.78	185.64
1996	4.30	10.00	4.31	1996	10.09	13.29	168.07

1997	2.70	9.30	2.65	1997	10.06	21.66	155.95
1998	1.88	7.80	0.52	1998	8.98	22.69	126.77
1999	1.10	7.60	2.36	1999	8.45	30.53	197.08
2000	5.40	8.40	4.15	2000	9.21	48.48	154.24
2001	3.10	8.30	2.74	2001	11.26	39.55	117.95
2002	1.55	9.10	3.67	2002	9.71	31.85	166.51
2003	10.30	10.00	3.12	2003	14.03	41.51	160.66
2004	10.60	10.10	4.86	2004	16.47	33.12	210.89
2005	5.40	10.40	4.97	2005	17.24	34.92	232.87
2006	6.20	11.60	5.32	2006	22.35	91.29	277.43
2007	6.45	13.00	5.10	2007	52.04	184.09	293.77
2008	6.00	9.00	3.06	2008	24.05	64.56	177.71

Source: Authors' Computation using data from World Development Indicators

The economy of China had grown on a two-digit average between 2003 and 2009, in contrast to an average of below 5.0 per cent for South Africa. During the entire period, it is evident that the economic growth experienced by China was high and more relatively stable compared with Nigeria and South Africa. The basic question is what accounted for differences in economic growth experienced?

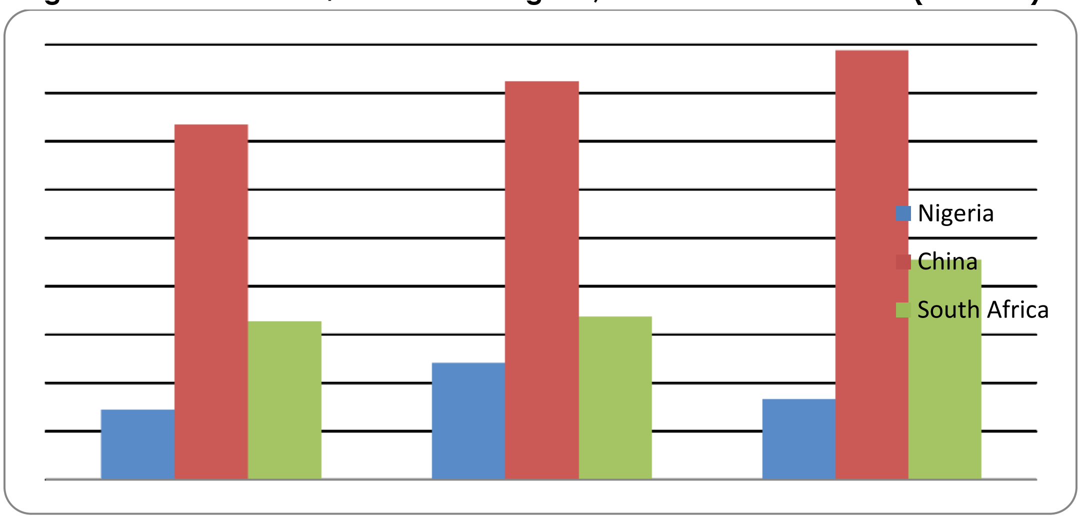
Figure 1: Savings as % of GDP for Nigeria, China and South Africa (Per cent)



Source: CBN Statistical Bulletin and WDI, 2011

China average rate of growth of GDP for the period of 1991 to 2004 was 10.0 per cent. Prior to financial reforms in China, gross capital formation averaged 27.4 per cent and this increased to 36.5 per cent for the period 2001 to 2008. As shown in Figure 1, the economic growth experienced by China is traceable to the continuous increase in both savings and investment. The domestic savings rate as percentage of GDP increased from 37.0 per cent in 1999 to 52.0 per cent in 2008. Also, during the same period, the percentage of investments to GDP increased from 36.0 per cent to 43.0 per cent (see Figure 2).

Figure 2: Investment as % of GDP for Nigeria, China and South Africa (Per cent)



Source: CBN Statistical Bulletin and WDI, 2011

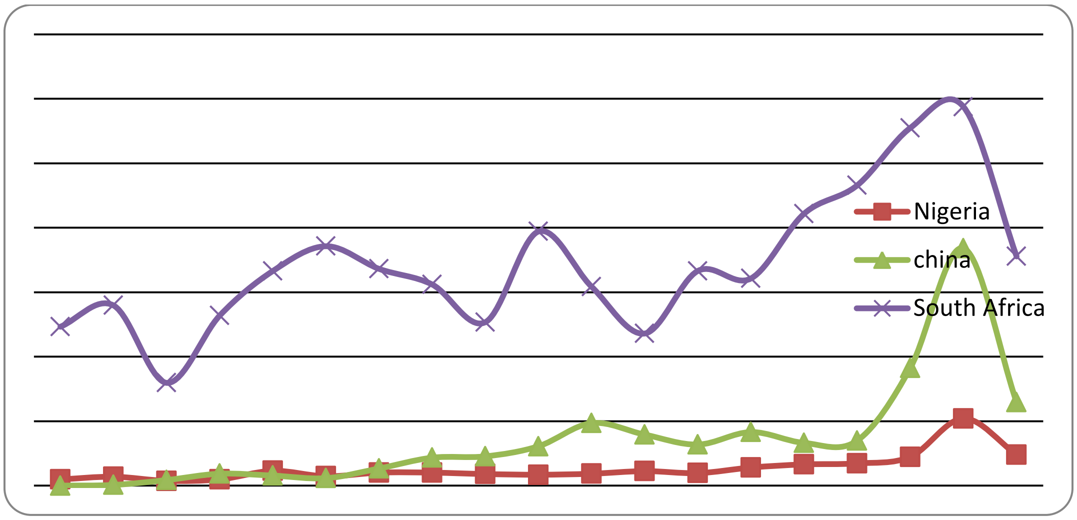
South African economic growth is driven by increase in investment, as it is observed that in the period of 1999 to 2008, gross investments was always greater than savings. The contrast is the case with Nigeria, as the increase in savings rate from 11.0 per cent in 1999 to 21.0 per cent in 2008 was not matched by the corresponding increase in investments rate. In the period of 2003 and 2008, investments as a percentage of GDP decreased from 11.0 per cent to 7.0 per cent (see Table 2)

(b) Capital Market Development

From Figure 3, China that established stock exchange market in early 1990s performed better in terms of market capitalisation compared to Nigeria. South

Africa has the best stock and bond markets among the selected countries. In the period 1990 to 2000, the value of market capitalisation in South Africa was more than the GDP. It increased from 123.2 per cent in 1990 to 154.2 per cent in year 2000 and as high as 277.4 per cent in 2006. The case of Nigeria can be regarded as an emerging capital market as the market capitalisation as a percentage of GDP was less than 10.0 per cent, and only increased from 4.8 per cent in 1990 to 9.2 per cent in 2000.

Figure 3: Market capitalization as % of GDP in China, South Africa and Nigeria



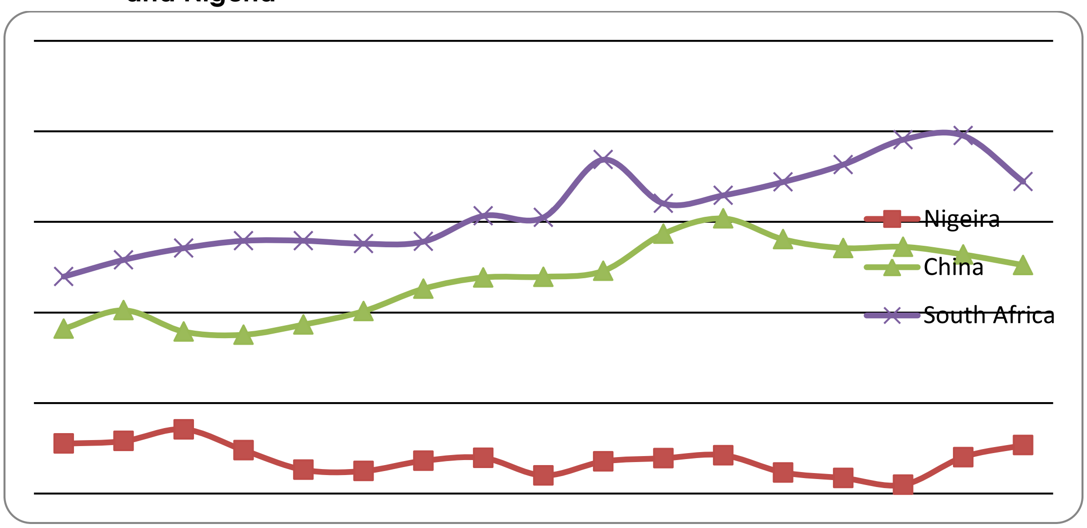
Source: World Development Indicators, 2011

Also, on the average, Nigeria position was better compared with China in the period of 1991 to 1995, as the indicator had an average value of less than 6.0 per cent compared with Nigeria with an average value of 8.0 per cent. The implementation of the Security Law of 1979 led to a dramatic turn-around in China in the period of 2000 and 2007, as market capitalisation increased from 48.9 per cent to 184.1 per cent, respectively. Though Nigeria also recorded an improvement during the period, but it was less compared with South Africa and China. The effect of the global financial crisis was felt in all selected countries as all of them recorded lower market capitalisation in 2008. The impact was more pronounced in China and South Africa. This is an indication that capital markets of China and South Africa are more integrated into the global economy compared with Nigeria.

(c) Private Sector Development

Another indicator worthy of consideration is bank credit to private sector. South Africa and China-despite being a late-comer into the market economy-had a viable private sector that has been an increasingly dynamic component of the economy and a potent engine for economic growth. This was made possible by the rapid development of financial intermediation by continuous increase in bank credit to the private sector. As shown in Figure 4, in South Africa, for the period 1992 to 2008, domestic bank credit as percentage of GDP had been more than 100.0 per cent ranging from almost 120.0 per cent in 1992 to 172.0 per cent in 2008. In China, it increased from more than 100.0 per cent in 1997 to 126.0 per cent in 2008. The contrast is the case for Nigeria as the value was less than 30.0 per cent during the same period. In China and South Africa, it takes a well-developed financial sector as well as business friendly environment to channel these domestic resources into the private sector.

Figure 4: Domestic Bank credit to private sector as % of GDP in China, South Africa and Nigeria



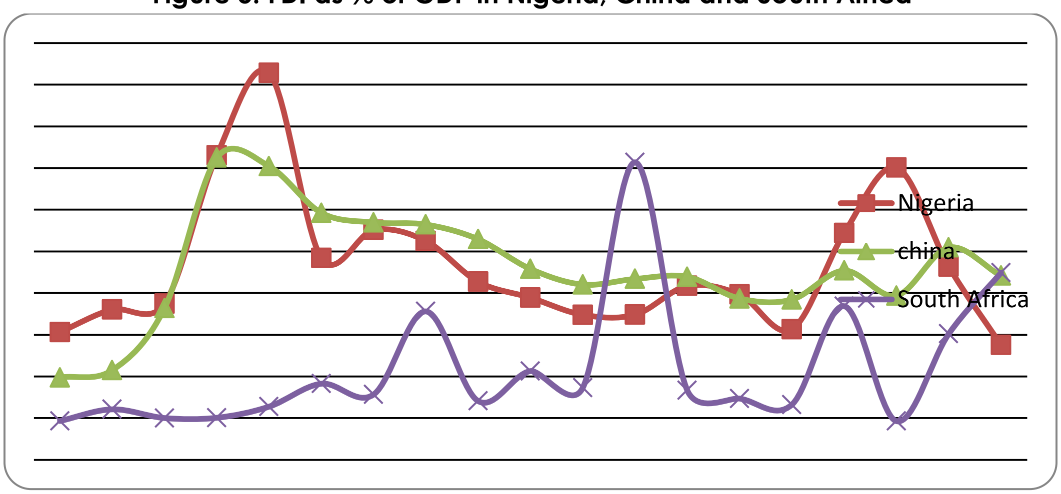
Source: World Development Indicators, 2011

In Nigeria, the public sector perceives the banking sector as the main source of deficit financing. Among the countries considered, Nigeria has the lowest credit to the private sector. If the private sector is regarded as engine of growth, it behoves, therefore, that the sector should not be deprived of necessary resources to propel economic growth. This low level of credit to private sector is a clear attestation to the fact that it is easier for the public sector to access bank credit compared with the private sector.

(d) Foreign Financial Flow

Moreover, China was able to attain a higher rate of economic growth because it could attract substantial volume of FDI. As a result of lower production costs, enormous market and preferential treatment of foreign investors, FDI in China grew from an average of US$1 billion a year to US$100 billion annually. The FDI further leads to economic modernization, technology transfers, job creation and human capital development. The contrast is the case of Nigeria. The bulk of FDI is targeted at extractive industries, especially petroleum sector. Moreover, deposit outflows accounted for more than half of total gross capital outflows (Olayiwola and Okodua, 2009). Figure 5 clearly showed that for the Chinese economy, trends in FDI and economic growth exhibited similar pattern over the period, while remittance experienced consistent and gradual upward trend. This strongly suggests that FDI remains a major source of economic growth in China. Surprisingly, trends in FDI and economic growth for Nigeria did not show such similar pattern as observed for China.

Figure 5: FDI as % of GDP in Nigeria, China and South Africa

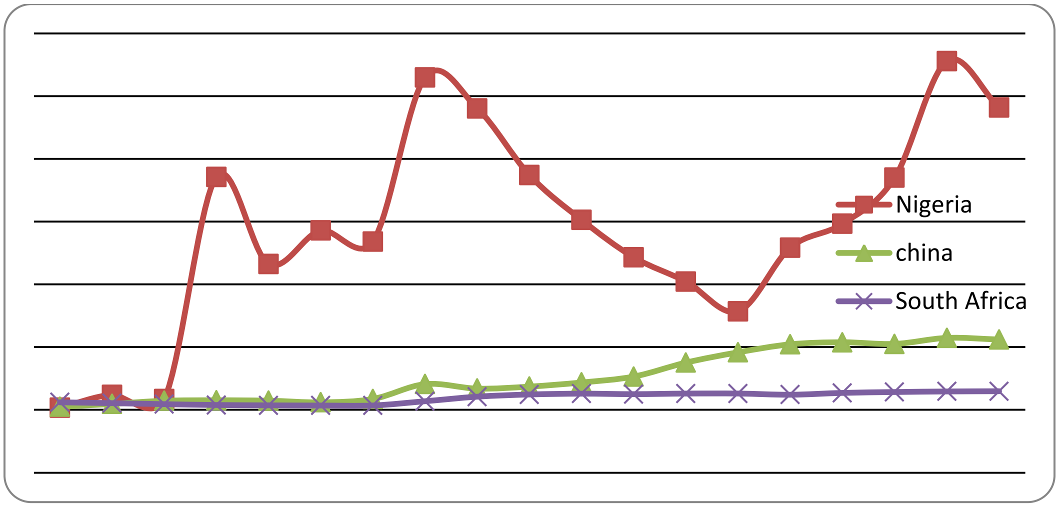


Source: World Development Indicators, 2011

Also, remittance is expected to be an additional source of growth financing in terms of its contribution to savings and investment. Figure 6 clearly shows that

Nigeria had a higher ratio of remittance to GDP among the selected EME countries. On the average, remittance to GDP ratio of South Africa and China was less than 1.0 per cent. Comparatively, the average value was 5.0 per cent from 1990 to 2008 in Nigeria.

Figure 6: Remittance as % of GDP of Nigeria, China and South Africa



Source: World Development Indicators, 2011

However, the growth impact of remittance is questionable as the real impact cannot be understood, nor government policies have any control on its destination and use. Even, market forces are unable to channel the resources to the most productive sectors.

IV. Challenges and Constraints of Nigeria in the context of Finance for Growth

From the previous section, the basic question to ask is why Nigeria had poor performance compared with other selected EME countries in nearly all indicators of finance-growth nexus?

(a) The Financial System

Financial system encompasses two major concepts: financial market (such as bonds, stocks and foreign exchange) and financial institutions (banks, insurance companies, mutual funds, among others). Since 1999 to date, the financial system in Nigeria experienced a great deal of transformation both in the number, quality and varying degrees of services it provided. However, the positive impact from such transformation in the development of the real sector of the economy has not really materialised. This can be attributed to the practice amongst operators that placed their individual corporate interest higher than the larger economy. The major challenge of Nigerian financial system is weak enforcement of corporate governance principles.

A review of the legislation relating to corporate governance in the banking sector and the analysis of the standard of corporate governance in Nigeria clearly show a divergence between the code of corporate governance and its compliance (Olayiwola, 2010). This divergence, therefore, raises many issues. Institutions and the legal framework for effective corporate governance appear to be in existence. Banks in Nigeria negate the basic hallmarks of banking principles, which are high degree of professionalism, transparency, and accountability. These are very essential for building strong public confidence in the banking industry.

The systemic distress in the sector and unpleasant consequences on all shareholders, therefore, call for improvement in good corporate governance. An assessment of the health of deposit money banks in 2009, shows that 11 of them were exhibiting serious weaknesses in the sense that they were unable to meet the stipulated minimum of 10.0 per cent Capital Adequacy Ratio (CAR). Also, the assets quality of these 11 banks, measured as the ratio of non-performing loans to industry total, deteriorated by 26.5 percentage points to 32.8 per cent between 2008 and 2009, higher than 20.0 per cent international threshold and the maximum prescribed by the Contingency Plan for Systemic Distress (CBN, 2009).

Apart from this, the performance of the sector in terms of its contribution to value added show that the sector dropped from 1.7 per cent in 2006 to 1.6 per cent in 2008 but increased to 1.7 per cent in 2009. The present condition of the financial system in Nigeria is far from being ideal, and achieving the goals may be challenging. Government interventions were taking place in the presence of weak professional capacity and large amount of doubtful loans.

Table 2 clearly showed that Nigeria has the highest bank capital to assets ratio among the selected countries from 2002 to 2008, ranging from 10.7 per cent to 18.0 per cent. The worrisome part was the non-performing loans of banks, which was as high as 22.6 and 21.6 per cent in 2000 and 2004, respectively. South Africa had a value less than 4.0 per cent during the same period under consideration. It would be observed that various CBN reforms yielded positive results as there were significant decline of 6.3 per cent in 2008.

Table 2: Bank Non-Performing Loans to Total Gross Loans in Nigeria

Bank capital to assets ratio (%)				Bank non-performing loans to total gross loans (%)			
Year	Nigeria	China	South Africa	Year	Nigeria	China	South Africa
2000	7.4	n.a	8.7	2000	22.6	22.4	n.a
2001	7.5	4.1	7.8	2001	19.7	29.8	3.1
2002	10.7	n.a	9.3	2002	21.4	26.0	2.8
2003	9.6	3.8	8.0	2003	20.5	20.4	2.4
2004	9.9	4.0	8.2	2004	21.6	13.2	1.8
2005	12.4	4.4	7.9	2005	18.1	8.6	1.5
2006	14.7	5.1	7.9	2006	8.8	7.1	1.1
2007	16.3	5.8	7.9	2007	8.4	6.2	1.4
2008	18.0	6.1	n.a	2008	6.3	2.4	3.9

Source: World Development Indicators, 2011

(b) Financial Market

Table 3 showed that Nigeria financial market lacks the liquidity needed for a sustainable bond market that can fund growth and development in the public and private sectors. In this table, the proportion of market capitalisation (MK) to GDP fell from 52.0 per cent in 2007 to 20.2 per cent in 2009.

Table 3: Proportions of Market Capitalisation (MK), Financial and Insurance Sectors to GDP, 1999-2009

Year	MK (N'Billion)	Financial Sector/GDP (%)	Insurance/GDP (%)	MK/GDP (%)
1999	0.00	1.36	0.04	8.45
2000	0.00	1.06	0.03	9.21
2001	0.00	1.26	0.04	11.26
2002	0.00	1.23	0.04	9.71
2003	0.00	1.05	0.03	14.03
2004	1.93	0.99	0.03	16.47

2005	2.90	0.98	0.03	17.24
2006	5.12	1.69	0.05	22.35
2007	10.19	1.60	0.05	52.04
2008	6.45	1.56	0.05	24.05
2009	4.26	1.74	0.05	20.18

Source: CBN Annual Reports and Financial Statement (various issues)

It is also obvious that Nigeria lacks non-banking financial services, such as securities market and insurance. The contribution of non-banking financial sector to GDP was less than 2.0 per cent from 1999 to 2009. The sector seems under developed to sustain a liquid securities market on its own.

(c) Financial Intermediation

Why is this channelling of funds from savers to spenders so important to the economy? The answer is that the people who save are frequently not the same people (entrepreneurs) who have profitable investment opportunities available to them. Without the existence of financial markets, it would be difficult to transfer funds from a person who has no investment opportunities to the one who has.

The average savings- GDP ratio in Nigeria was less than 30.0 per cent compared with 48.0 per cent for China and 43.0 per cent for South Africa from 1999 to 2009. Apart from low savings, another major challenge is financial intermediation which is a good measure of ability of a country of converting savings to investment. Here, the savings-investment gap was adopted to measure this challenge. From 1999 to 2009, investment to GDP ratio was less than savings-GDP ratio as can be seen in Table 4.

Table 4: Savings and Investment in Nigeria (₦'Billion)

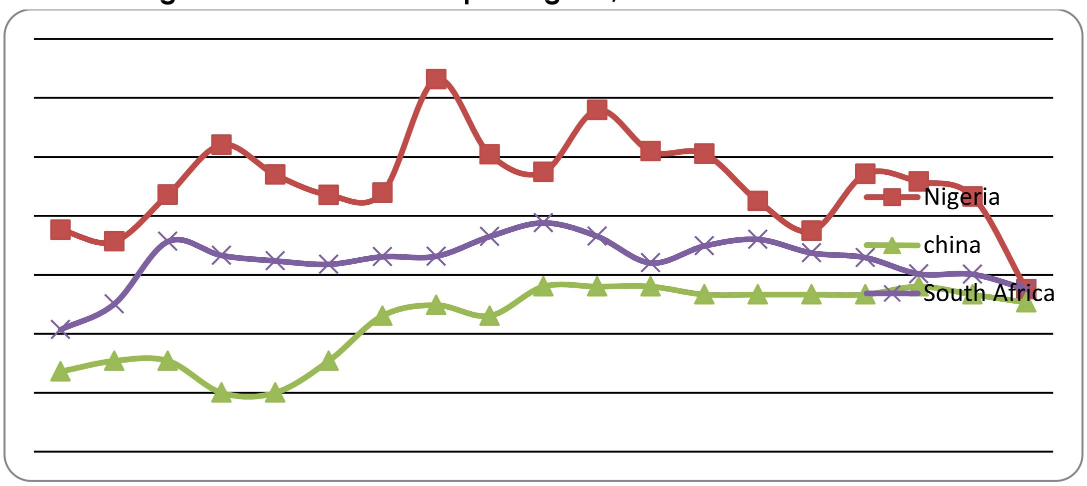
Year	Economic Growth (%)	S-I gap	S/GDP (%)	I/GDP (%)
1999	1.10	50.63	14.73	7.27
2000	5.40	79.36	35.42	7.31
2001	3.10	35.91	11.23	7.20
2002	1.55	40.89	15.52	9.18
2003	10.30	10.43	13.48	12.07
2004	10.60	62.78	20.34	7.57

2005	5.40	74.82	21.96	5.53
2006	6.20	67.69	25.81	8.34
2007	6.45	61.62	24.18	9.28
2008	6.00	62.32	22.20	8.36
2009	7.00	60.53	25.06	9.89

Sources: CBN Annual Reports and Financial Statements (various issues); World Development Indicators, 2011

The positive value of savings-investment gap is a clear indication that savings mobilised are not channelled to investment. The gap was more than 50.0 per cent for the period 1999 to 2009, except from 2001 to 2003. In effect, it was as huge as ₦79.36 billion in 2000 and ₦74.82 billion in 2005 (Table 4). This suggests the existence of sizeable unutilised domestic resources for productive purposes. The basic question here is why is there the presence of wide savings-investments gap in Nigeria?

Figure 7: Interest rate Gap in Nigeria, China and South Africa



Source: World Development Indicators, 2011

Figure 7 provides answer to the question. Among the selected EME countries, Nigeria had the highest lending rate ranging from 25.3 per cent in 1990 to 15.48 per cent in 2008. From 1999 to 2008, the average lending rate was about 6.0 and 20.0 per cent in China and Nigeria, respectively. In essence, the cost of borrowing in Nigeria is too high. With low borrowings by firms from banks, the borrowing cost depends on the operational efficiency and competitiveness of the banking sector. In this regard, the performance of Nigeria falls behind, as financial reform has been associated not only with higher lending interest rates, but also with a widening of intermediation spreads—at least partly reflecting increased exercise of market power by banks.

(d) Fiscal Federalism in Nigeria

Another major challenge is the fiscal federalism as practised in Nigeria. From Table 5, the Federal Government exercises legislative control of about 71.1 per cent of tax base in Nigeria (15 out of 21), the State Government has control of about 28.6 per cent (6 out 21), while the Local Government has no control. The State Government is responsible for the administration and collection of 50.0 per cent (11 out of 21), of taxes while local governments are responsible for administering and collecting only 9.5 per cent (2 out 21).

Table 5: The Structure of Tax System in Nigeria

	Jurisdiction	
Number of Taxes	Legislation	Administration and Collection
Federal Government	15	8
State Government	6	11
Local Government	0	2
Total	**21**	**21**

Sources: Development Policy Centre, 1998; FIRS, 2008; Olayiwola and Osabuohien, 2010

The resulting fiscal structure is termed *Fiscal Hydrocephalus* (Olayiwola and Osabuohien, 2010). Hydrocephalus is a medical condition where the head gets very big while the limbs and the rest of the body become stunted, usually arising from the accumulation of excess fluids in the brain and is known to result in serious mental retardation with a high risk of paralysis, and even death (DPC 1998; Olayiwola and Osabuohien, 2010). Thus, the fiscal structure in Nigeria is likened to this disease, as over-concentration of resources at the Federal Government level is regarded as "big head" and the deprivation of both the state and local governments of necessary resources is referred to "stunted body and limbs" (Olayiwola, 2008). Due to the limited capacity of states to generate domestic resources to finance their expenditure, nearly all states in Nigeria "run" to money and capital market to source for funds. In the process, they deprive the private sector access to the limited available resources.

V. Policy Options and Conclusion

The analysis has clearly revealed that finance is important for a sustainable economic growth. It also shows that financial policies designed in various EME countries had the main aim of making the financial system provide financial functions. However, there are large differences in *how well* the financial system in each country performed these functions. Also, it is well noted that what matters to economic growth is access to financial services and not who supplies them, whether it is private sector as in South Africa and Nigeria or the combination of public and private sectors as in China.

The financial policy in Nigeria has not been able to achieve the desired result in providing financial services. The country has not experienced a remarkable economic growth like other EMEs. It has very weak money and capital markets that can perform the role of mobilising savings and financial intermediation. The private sector is weak and there is an unhealthy competition between the private and public sectors in terms of access to bank credits. The country fails in attracting appropriate FDI and shows a remarkable performance in terms of remittance that is very difficult to channel to investment ventures. All these challenges are attributed to weak and unstable banking system, high lending rate coupled with wide interest rate gap and fiscal misalignment of the public sector.

As an emerging economy, Nigeria should take the advantages of accompanied potential benefits of an emerging market by mitigating major constraints to financial sector development and create conducive atmosphere for inflows of foreign capital. The financial market remains weak and could not afford a closed financial system with exclusively “domestic” banks and other intermediaries. Foreign banks will be needed to complement domestic banks in rendering financial services. The country is too small to do without the benefits of access to global finance, including accessing financial services from foreign or foreign-owned financial firms.

Appropriate policy option must build confidence in the financial system as well as enhancing financial intermediary.

1. Monitoring of banks and exerting corporate governance is very essential. Corporate governance is central to understanding economic growth in

general and role of financial factors in particular. In the spirit of corporate governance, the CBN must overcome the challenge associated with problems of information asymmetry. The complexity of modern economic and business activity has greatly increased the variety of ways in which insiders try to conceal banks' performance. Although progress in technology, accounting, and legal practice has improved the tools of detection, the balance of the asymmetry of information between users and providers of funds has not been reduced in Nigeria. Legal infrastructure may need upgrading, and judicial enforcement is the most relevant. Where the rule of law is weak, the financial sector cannot be expected to function well.

2. Policy should be directed at helping the Nigerian economy to absorb bank credit in the real sector so as to translate these flows of domestic resources into economic growth. The authorities need to aim at removing barriers that prevent borrowers and lenders from accessing money and capital markets such as high lending rate and stringent conditions attached to bank credits

3. Government ownership of banking should be discouraged as there is clear evidence that the goals of such ownership are rarely achieved in Nigeria. It weakens the financial system rather than the contrary. Central bank intervention in the ownership of banks should be limited to the crisis period. Drawing on public funds to recapitalise some banks may be unavoidable in truly systemic crises, but they must be used sparingly to leverage private funds and incentives. Procrastination and half-measures bear a high price tag that will affect the financial system and the economy.

4. Exploring the possibilities of regional cooperation especially in the area of capital market development will bear a positive result. If democracy is weak and ethnic conflict high, a significant level of uncertainty will likely prevail, which will deter physical entry by good investors. E-finance or joining a regional financial system may be the best hope of getting access to higher quality financial services. The idea of ECOWAS regional capital market, ECOWAS Common Investment Market and ECOWAS Regional Monetary Cooperation are good initiatives that should be supported.

In conclusion, in an EME country like Nigeria, there is ample evidence of the importance of sound financial infrastructure in the context of finance for growth.

Unregulated financial system will fail, but the wrong type of regulation is counterproductive. The *right* types of regulation are "incentive" and "sanctions". Incentive and sanction system should be designed with a view to ensuring that the impact they create for market participants helps to achieve their goals rather than hinder them.

More specifically, the right type of regulation should:

- Work with the market, but does not leave it to the market.
- Keep authorities at arm's length from transactions, lessening the opportunities for conflicts of interest and corruption; and
- Promote prudent risk-taking.

In fact, the financial policy must be *market-aware*.

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Good Governance, Transparency and Regulatory Issues in Financial Sector Development and Stability

Professor Bolaji Owasanoye*

I. Introduction

Good governance and transparency are words of common usage in present times. Good governance connotes many things, but is anchored on the desire of the state to develop. "Development" as a concept is also fraught with a vagary of divergent factors that are not easily subjected to measurement. It has been said that it is easier to speak of rich and poor countries than to speak of developed or not developed economies because the indicators of wealth, which reflect the quantity of resources available to a society, provide no information about the allocation of those resources[1]. As a result, citizens of countries having similar incomes may not enjoy similar quality of life.[2]

United Nations documents emphasize that "human development is best " measured by life expectancy, adult literacy, access to all three levels of education, as well as people's average income, which is a necessary condition of their freedom of choice. Therefore, the notion of development incorporates all aspects of individuals' well-being, from health status to economic and political freedom[3]. "Human development being the end, good governance and economic growth will be the means."[4]

Development can also be seen in both physical and psychological realities. The physical reality of development is found in the existence or availability of real and tangible structures of development or infrastructure like schools, hospitals, roads,

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[1] "What is Development?" www.worldbank.org/depweb

[2] see generally Bolaji Owasanoye "Rule of Law and National Development" in Rule of Law and Good Governance, Azinge and Owasanoye ed. Nigerian Institute of Advanced Legal Studies, 2009 pp. 304-324.

[3] See generally UN Human Development Reports http://undp.org

[4] Ibid UNHDR 1996.

bridges, factories, etc. while the psychological reality is considered essential for the enjoyment of the benefits of physical development[5].

Good governance as a concept is generally recognized to have basic features viz. poverty alleviation; security of life and property; maintenance of law and order and an acceptable level of infrastructural development. In the context of financial sector regulation, it implies that the focus and objectives of the regulator should be how to regulate to guarantee poverty alleviation; improve the security of life and property; enhance maintenance of law and order and sustain an acceptable level of infrastructural development that would foster economic growth.

I.1 Financial Services Sector

The financial services sector of any economy is the channel through which financial resources mainly capital are transmitted to the economy. The key functions of the sector may be summarised as; mobilization of savings from different parts of the economy; allocation of capital to needy sectors based on scale of return; monitoring the use of investments either by government, corporations or individuals; and assessment and management of financial risks for investors.

Given the importance of these functions to the economic health of a nation, regulation of financial services sector is taken seriously and is the function of different agencies led by the Central Bank. The powers given central banks by law, underscore the importance of law in financial sector regulation in order to ensure the fulfilment of the objectives of the financial sector and guarantee stability and growth. In this regard, central bank regulatory powers are constantly reviewed to enable it superintend financial sector stability in response to modern trends and international best practices. For example, the powers of Central Bank of Nigeria (CBN) to regulate the financial services sector was enhanced by the passage of the Central Bank Act of 2007[6].

I.2 Regulation and Development

Regulation as a concept in economic management is founded on the ideology of development as a key objective of governance. As was noted by White[7] -

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[5] Amartya Sen (1999). *Development as Freedom*. (Alfred Knopf: New York) p. 75

[6] Before 2007 the CBN Act was revised in 1991 33 years after the enabling act was first passed.

[7] Developmental States and Socialist Industrialization in the Third World' *Journal of Development Studies*, 21, 1 Oct. 1984.

> *"The modern notion of `development economics' rests on a more or less explicit concept of the state as a crucial stimulant and organizer of socio-economic progress. This intellectual paradigm has drawn historical sustenance from the argument that the developmental process is less 'spontaneous' more subject to teleological determination, with the state as the major agent of social transformation in both capitalist and socialist contexts..."*

In other words, we cannot separate state intervention by regulation as a necessary factor in the objective of development or good governance. The limit of state intervention is, thus, defined by the statutory power to regulate. The power of the CBN to regulate the financial services sector is found in the CBN Act[8] and the Banks and Other Financial Institutions Act[9]. Specifically, section 2(a) of the CBN Act gives it power to promote monetary stability in Nigeria. This it does by issuing monetary policy circulars from time to time. These policy circulars are obligatory on players in the sector and are regarded as subsidiary instruments having the force of law.[10]

This position is affirmed by sections 56 and 59(2) (a) of Banks and Other Financial Institutions Decree No. 25 of 1991, which gives the Governor of the Central Bank power to make regulations to control institutions under his jurisdiction generally and mandates every bank to comply with the Monetary Policy Guidelines and other directives as the Bank may, from time to time specify, respectively.

II. Transparency and Accountability

Transparency and accountability are expressions of common usage in Nigeria although they are vanishing ideals. Every institution of government appears to idolise the concepts, but the more they are highlighted, the more elusive they appear to be in practical terms and implementation. The recent global financial crisis revealed the underbelly or absence of transparency and accountability in Nigeria's financial services sector.

The global financial crisis underscores the importance of regulation but also its limitations. There is no doubt that the financial crisis was accentuated by the

[8] No. 63 of 2007
[9] Decree No. 25 of 1991, now Cap. B3 LFN 2004
[10] See section 12(1) Interpretation Act cap 192 LFN 1990

absence of transparency and accountability and the failure of the rule of law wherein regulators failed to use law to minimise the impact of the crises on the local economy. The crisis also revealed the underbelly of legal regulation, indicating that many aspects of finance, financial policy and financial law and regulation need rethinking at international, regional and domestic levels. We must, however, not lose sight of the fact that the reaction of the regulatory authorities to the crisis was situated within the statutory powers. Such powers were invoked to address the crises as soon as the regulator found the political will to act. In other words, on the one hand, the crises escalated because the law was not followed, while on the other hand, the ultimate power to address the crises was found within the law as soon as the regulator found the courage to act.

III. Rule of Law in Financial Sector Regulation

The rule of law is a mix of technical or procedural components, as well as substantive moral content that encompass a system where institutions and officials are guided and constrained by the law, i.e., government that is accountable to, not above, the law; a body of laws that are transparent, reasonably predictable, validly derived, and fairly and equitably applied; laws, principles and procedures that protect those civil, political, and economic rights that have become enshrined as universal human rights; and a fair and effective legal system led by an independent and professionally competent judiciary that acts as the final arbiter of the law. The term "rule of law" also relates to the process rather than substance and refers to law made by legitimate authority, certain, clear, publicly accessible, consistent, prospective, and commanding obedience.

One of the challenges faced by rule of law in Nigeria is that its principles are hardly observed. Access to legislation and regulatory guidelines or subsidiary instruments both substantive and subsidiary is a major challenge[11]. For example, the CBN monetary policy circulars have the force of law as subsidiary instruments made pursuant to its powers under section 51 of the CBN Act but the policies are not readily accessible by the public either in printed format or on CBN website. For effective financial sector regulation, it is not only financial services providers who ought to be notified of the CBN circulars, members of the public for whom

[11] Different versions of laws already passed and in the process of being passed are often in circulation to the consternation of the end user. Recently, the Senate raised alarm at the prevalence of differing versions of law on sale on street corners. It is said that eight or more versions of the Petroleum Industry Bill exist in Nigeria

such regulations are made ought to have easy access to such circulars. This will also assist transparency as we will discuss later. There is also the challenge of blatant disobedience to laws and the inability or lack of will power on the part of regulator and law enforcers to command obedience and punish offenders.

In the context of financial services, absence of rule of law means that uncertainty will reign in the economy. Without transparent legal rules, the cost of doing business rises with further consequences leading to increased cost of raising capital, higher risk premiums, and lack of fidelity amongst players. Debtors will not repay debts because they know that laws and contract obligations are not consistently enforced. In such a set-up, corruption thrives and spreads like a virus. Therefore, the rule of law provides an essential framework for economic activity.

IV. Some Regulatory Powers of CBN Relative to a Developing Economy

Given the wide powers of CBN in its enabling statutes it is not possible to discuss in-depth all its regulatory powers in a short paper of this nature, therefore, we will focus on the following viz. payment system regulation, external reserves management, power of supervision and micro credit policy framework.

IV.1 Payments System

Payments system is important for the proper functioning of financial markets and the economy. There is a linkage between an effective payment system and the economy as a whole. Thus, problems affecting the payments system affect the entire financial system and the economy as a whole. Section 47 of the Central Bank of Nigeria Act 2007 provides for the Bank to facilitate the efficient clearing of cheques and credit instruments and to establish clearing houses for the purpose.

The exchange of payment related information between system participants and any regulations under which payments are settled on a bilateral or multilateral basis is known as clearing. Settlement implies the actual discharge of an obligation, i.e. by debiting the specific amount from the payer's account, and crediting the payee's account, while the infrastructure, which facilitates the clearing and settlement of financial instruments is known as the payment system.[12] Efficient payments system provides the basis for the Central Bank's

[12] O. J. Nnanna and M. Ajayi : The Role of Payments System in Liquidity Management: Central Bank in Perspective. CBN BULLION Vol 29 No 1 Jan -March 2005 p.34

liquidity forecasting and management process, the features of which affect the demand and supply of bank reserves, credit delivery and support for economic growth.

The modernisation of the process for handling payments started with the Magnetic Ink Character Recognition (MICR) programme of the CBN, which involved the phased adoption of MICR technology for processing of inter- bank transfer and in- house cheques. This was followed by the establishment of Automated Teller Machines (ATMs) for cash dispensing, account balance enquiry and payment of utility cheques. The ATM in turn provided links to online customers and other account systems among bank branch network to facilitate payment services. Currently, CBN has introduced cash-less economy policy, effective April 2012 starting with a pilot in Lagos State. The policy is aimed at reducing the cost of handling cash, enhance security and diminishing the opportunities for money laundering, amongst others[13].

Settlements through inter-branch transfers are currently undertaken almost instantaneously. Cheque clearing cycle is T+3 for local and up country. Even then the time can be shortened as the market keeps evolving with the introduction of modern facilities.

The link between the payments system and liquidity management is reflected in the interface between liquidity and payment channels.[14] A major payment system failure would bring countless commercial transactions to an abrupt halt, impede the operation of business in virtually all parts of the economy and fundamentally undermine investor and business confidence. This is a major concern with regard to the introduction of the cashless economy because the infrastructure to back up the effective and efficient implementation of the policy is not yet in place while the public education component is inadequate in the light of the fact that the Nigerian economy, which is dominated by the informal sector, is largely run on cash-and-carry basis. Vulnerability to fraud is also a major concern as expressed by the security experts.[15]

[13] see generally http://www.cbn.gov.ng/cashless/ accessed, 22nd April 2012
[14] Ibid p.38
[15] Nation Newspaper 20th April 2012

IV.2 External Reserves Management

External Reserves are external assets of a country that are readily available to and managed by the CBs for direct financing of government's expenditure, intervention in foreign exchange markets and meeting other external financing commitments. By section 24 of the CBN Act, the Bank is required to maintain at all times a reserve of external assets consisting of all or any of the assets specified in the section.

Section 25 provides that the Bank shall use its best endeavours to maintain external reserves at levels considered by the Bank to be appropriate for the country and the monetary system of Nigeria. According to Nnadi, a distinction should be made between a country's external assets and its external reserves. A country's external assets comprise the foreign exchange holdings of the government, semi-official institutions, commercial and merchant banks and that of the Central Bank of that country while the Central Bank's component of the external assets may be interpreted as its reserves[16]. The reserve management strategy of the CBN is anchored on liquidity management, adequate returns and capital preservation. In this case, the Bank holds the larger proportion of its reserves in secure, liquid though low yield assets such as government bonds and time deposits with reputable international financial institutions.[17]

Sections 2 and 24(h) of CBN Act and Good Governance[18]

Section 2: Delegation of Management of Foreign Reserves

One of the much-touted reasons for the bank consolidation policy embarked upon in 2005 was the possibility of delegating the management of the nation's external reserves to the newly consolidated and stronger deposit money banks. In anticipation of this, many of them established partnerships with foreign banks. Although section 2(c) of the Act placed responsibility for management of reserves on the CBN, it was speculated that the CBN planned to delegate this function. Delegating this duty would be in breach of one of the CBN's main functions. If the law wished CBN to delegate the management of reserves it would have so expressed as done under s.36(3) which empowers it to delegate

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[16] Ben C. Nnadi: "International Reserve Management: A Synopsis" CBN Bullion VOL. 27 No 1 2002 p. 39
[17] Sheriffdeen A. Tella: Overview of External Reserves Management in Nigeria CBN Bullion Vol. 31 No.2 April-June 2007. P1 at p.8
[18] See generally H.K. Fujah CBN Act 2007 A Review pub. HK. Fujah, 2009.

the power of collecting and paying government money in places where it has no branch.

Section 24(h) says - The Bank shall at all times maintain a reserve of external assets consisting of all or any of the following:

(h) Investment by way of loan or debenture in an investment bank or development financial institutions within or outside Nigeria for a maximum period of five years in so far as:

(i) the amount invested is no more than 5% of the total foreign reserves;
(ii) the reserve level at the time of investment is more than such amount as will sustain twenty four months of import; and,
(iii) the loan or debenture is denominated in foreign currency.

The section empowers CBN to lend part of Nigeria's foreign reserves to private local and international entities ostensibly to enhance national revenue since the assets will earn interest. The provision seems to have been influenced by the positive health of the nation's reserves at the time of the passage of the 2007 Act. The rationale was that such healthy savings ought not to be left idle in the accounts. The ambiguous provision prescribes 5per cent but does not say if this is limited to one or all banks? Can CBN lend 5 per cent of foreign reserves at any point in time to each and every applicant? The answer would, in practical terms, seem to be in the negative but that does not cure the ambiguity. According to Fujah (2009), the provisions do not address some key issues.[19]

(a) It assumes that the nation may never need to make provision for more than 24 months imports or that the economy is unlikely to expand to such level;

(b) It suggests that national funds could be more secure with private entities than with public. Recent developments had, however, showed that private banks both local and international can become distress and can be wound up. Government cannot be wound up, though they may, like companies, face economic hardship. The confidence reposed in private entities to invest national reserves is misplaced and unduly optimistic. Nigeria's private

[19] Ibid.

sector has not performed up to expectation in many respects nor exhibited a higher standard of probity than the public sector;

(c) Lending will be unsecured with all the attendant risks that are associated with it. In the absence of security, what is the consideration that would be offered by the borrowers of public funds given that the CBN frowns at local banks for unsecured lending that exposes them to undue risks and threatens shareholders' and depositors' funds? How does the CBN hope to prevent risk to national funds. Besides, the suggestion of the provision negates the safety inherent in the policy that CBN cannot lend to public bodies without government guarantee. Note that section 29(e) and (g) of the Act requires CBN to lend local currency to public and private bodies only upon provision of collateral e.g. Treasury bills.

(d) The provision benchmarks the amount lendable against the country's stock of reserves i.e. the more we save the more you can lend out. This negates the practice of lending against the borrower's capacity and not the lender's capacity. Indeed s.38 of the same Act enjoins CBN to lend to the Federal Government of Nigeria only against the FGN's actual revenue not against the money in the CBN's vaults.

(e) The period for which money can be lent out is also questionable. Five years unsecured lending of national assets to private banks cannot be said to be prudent especially in the light of s.38 mentioned above which allows the CBN to lend local currency to Federal Government of Nigeria (FGN) for one year only. Why allow CBN to lend foreign currency unsecured for five years to private institutions?

(f) Will the CBN make provision for such loans in its books and accounts as it mandates banks to do? Will the CBN humbly anticipate the failure of some of the loans and provide for them? If yes, how much of the loan it grants will it provide for without making its books and the economy look negative in presentation and projections.

Section 24(h) makes the CBN attractive to banks that it is supposed to regulate. Though regarded as lender of last resort, with the possibility of generous unsecured money available for five years, CBN may become the first and last port of call for banks looking for cheap and free foreign currency. The question of whether the CBN will be morally upright in its dealings with those to whom it has lent money remains unclear? It may, thus, be asked, is this good governance?

If, as has recently happened, the local banks that borrow under this provision become insolvent for any reason, the CBN is required to bail them out with naira as lender of last resort. In this regard, public funds suffer double jeopardy in the hands of unscrupulous local banks.

In the light of the explanations by the CBN to states calling for the disbursement of savings in foreign reserves that they have already shared the naira equivalent through the approved revenue allocation formula, therefore, technically speaking, the money no longer belongs to states or FGN, would it not amount to releasing the same money into the economy twice if same were to find its way back through loans to private banks? Could this induce inflation? How much control would the CBN place on dollar loans to local banks. Is there any possibility that such money could be round trip by local banks to the foreign exchange market.

The 2007 re-enactment of the CBN Act seems to suggest that the CBN suddenly developed a commercial approach to managing public assets by seeking to invest foreign reserves in a manner that jeopardises the economy.

V. Supervision

Banks and Other Financial Institutions Act (BOFIA) empowers the CBN to conduct special examination. In order to properly appreciate the extent of these powers especially in the light of recent actions taken by the CBN against weak banks and the challenge of those actions, we will set out extensively the powers of CBN on supervision of banks. Section 33 of the BOFIA provides:

(1) The Governor shall have power to order a special examination or investigation of the books and affairs of a bank where he is satisfied that-
(a) it is in the public interest so to do; or
(b) the bank has been carrying on its business in a manner detrimental to the interest of its depositors and creditors; or
(c) the bank has "insufficient" assets to cover its liabilities to the public; or
(d) the bank has been contravening the provisions of this Act; or
(e) an application is made thereof by-

(i) a director or shareholder of the bank; or
(ii) a depositor or creditor of the bank:

This provision is strengthened by section 35 of the BOFIA, which gives similar wide powers over a failing bank including power to prohibit a failing bank from extending any further credit facility for a stated period; remove, for reasons to be given in writing, any manager, director or officer of the bank, notwithstanding anything in any written law, or any limitations contained in the memorandum and articles of association of the bank; appoint any person as director of the bank and order that the person so appointed be paid by the bank such remuneration as may be set out in the order; appoint any person to advise the bank in relation to the proper conduct of its business, and provide, in order for the person so appointed to be paid by the bank, such remuneration as may be set out in the order. If the steps enumerated above have been taken and the affected bank does not improve, the CBN might, under section 36 and 37 of the BOFIA hand over the failing bank to the Nigerian Deposit Insurance Corporation (NDIC) being the undertaker, to see to the painful euthanasia or otherwise of the bank.

These wide powers empower the CBN to maintain financial stability and consequently manage the economy and were recently used to sack the CEOs of eight banks and liquidated three banks. Furthermore, protection of depositors helps to prevent widespread panic withdrawal and damage to the economy by ultimate collapse of affected financial institution(s).

VI. Micro Credit Regime

The micro credit regime of the CBN was designed to assist vulnerable groups and persons with a view to empowering them financially so that they can contribute to the development of the economy. If effectively implemented, the regime would have tackled unemployment and acted as booster to productive activities by the larger segment of the population. Unfortunately, like many of the development policies of the Government the micro credit regime is yet to fully achieve its objectives.

A Human Development Initiatives (HDI) Report[20] observed that there are more areas to be covered to address the micro finance methodologies in Nigeria,

[20] Human Development Initiatives: The Philosophy and Loan Lending Practices of Selected Micro Finance Banks/ Institutions in Lagos State and the Grameen Bank Model 2010 p.17

when compared with what obtains in other jurisdictions. While the Nigerian guidelines focuses more on profitability and quality of micro finance banks, those in other jurisdictions focus on maximum outreach and poverty alleviation.

In an International Conference on Micro Financing organised by the First Bank of Nigeria in 2011, the World renowned micro finance expert Mohammad Yunus criticised Nigeria's micro finance regime as being tilted in favour of the rich at the expense of the poor.[21] Explaining the mechanism for the success of the Grameen bank, Yunus said: "What we did, was to look at conventional banking and do things the opposite way. Conventional banking is for the rich so we decided it should be for the poor. Conventional banking is for men; we set up Grameen Bank for women. Conventional banking is set up in the city, whilst microfinance bank is for the rural area. Conventional banks asks for collateral, we do not ask for collateral"[22]

The HDI report showed that microfinance in Nigeria seems to focus on how to make money and not on how to assist the poor. With such a damning verdict from an internationally renowned expert and a local survey report, it is not surprising that micro financing in Nigeria has not achieved its avowed objective of developing the economy.

VII. The Global Crisis and the Nigerian Financial Sector

Initially there were conflicting opinions as to whether the Nigerian Financial System was affected by the crisis that rocked the advanced western world[23]. It wasn't long, however, before it became clear to all that Nigeria was not spared. The cause of the crisis in Nigeria was not hinged on the failure of regulation, impact of corruption and poor corporate governance.

A joint CBN/ NDIC Audit investigation on the financial sector blamed the depletion of capital on poor or non-observance of corporate governance principles in the management of banks as well as outright fraudulent insider loans taken by directors of banks to fund private businesses. Investors and depositors

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[21] Yunus, Nobel Laureate, faults Nigeria's microfinance banking: Business Day 6th September 2011 http://www.businessdayonline.com/NG/index.php/news/76-hot-topic/26923-yunusnobel-laureate-faults-nigerias-microfinance-banking visited 25/ 10/11

[22] ibid

[23] For instance the former Governor of Central Bank variously assured the nation that the economy was not affected by the global crisis because of the enhanced capital base of the banks. See Princess Iphie 50 years of Central Banking in Nigeria –Icons, Issues, Perspective. 2009 p 116

were deceived by the operators with false reports of good performance published annually but never challenged or sanctioned by the regulator. Reports concealed huge non-performing loans to capital market operators and effect of divestment by foreign investors afflicted by the global financial crisis.[24]

Several local investors lost life savings in the stocks of banks as the capital market lost over 80 per cent of capitalization in one year. The attendant loss of employment in both banks and capital market underscored the depth of the crisis because the banking sector holding 65 per cent of the market capitalisation was in deep crisis.[25]

The 2009 audit report revealed serious illiquidity and poor state of capital of five (5) out of the eleven (11) banks that were initially audited. The other fourteen (14) were later audited and their results released on October 16, and another four (4) were found to be in the same dangerous state like the first 5. Eight (8) of the distressed banks had their Management sacked and a total of ₦620 billion was injected into the affected banks by the CBN to shore up their liquidity.

It is safe to say that the crisis in Nigeria has been escalated by a combination of international and local factors. While the internationalisation of the capital market exposed the sector to the vagaries of exogenous factors, local peculiarities like high level corruption, lack of political will and more importantly failure of corporate governance escalated the impact.

One cannot conclude that the crisis is over either globally or locally. According to the G20 Declaration of 2008,"…. regulation is first and foremost the responsibility of national regulators who constitute the first line of defence against market instability."[26] This implies that although a crisis may arise out of factors external to the economy, internal regulation remains the first line of defence. Indeed, we note that countries like Canada whose local regulators were proactive in using laws and policies as first line of defence were not burnt in the aftermath of the crisis[27].

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[24] Paul Ogbuokiri: Nigeria: Banking Sector – The Turmoil, The Crisis: http//allafrica.com/stories. Accessed 23/10/11

[25] Ibid

[26]Declaration Summit on Financial Markets and the World Economy http://www.g20.org/Documents/g20_summit_declaration.pdf Accessed 31/10/11

[27] "Worldwide Financial Crisis Largely Bypasses Canada"http://www.washingtonpost.com/wp-dyn/content/article/2008/10/15/AR20081

The Central Bank of Nigeria, in pursuant to the CBN Act 2007 from 2008 to date, has taken different measures to address the impact of the global financial crisis in Nigeria. The Central Bank's intervention is hinged on four pillars namely: [28]

1: Enhancing the Quality of Banks

This consist of industry remedial programmes, risk based supervision, reforms to regulation and regulatory framework, enhanced provisions for consumer protection and internal transformation of the CBN. It is under this reform head that bank chief executives were held accountable for their actions leading to the sack of same and appointment of new management for the banks.

2: Establishing Financial Stability

According to the Governor of the CBN "The key features of this pillar centre around strengthening the financial stability committee within the CBN, establishment of a hybrid monetary policy and macro-prudential rules, development of directional economic policy and counter-cyclical fiscal policies by the government and further development of capital markets as alternative to bank funding."

3: Enabling Healthy Financial Sector Evolution

Reforms in this area include banking infrastructure, banking industry infrastructure and role of the informal sector. The establishment of the Asset Management Corporation of Nigeria (AMCON) and the new banking model come under this reform head. Toxic shares of banks are assumed by the AMCON and would be retained for two years before they are traded on the open market. AMCON is billed to clear about US$10 billion by end-2012 at a cost of roughly US$5 billion.[29]

4: Ensuring the Financial Sector contributes to the Real Economy

Policy measures in this regard include making more efficient the development programmes of CBN such as the Agricultural Credit Guarantee Scheme (ACGS) micro finance and the Small and Medium Enterprises (SMEs) financing schemes.

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[28] Sanusi Lamido "The Nigerian Banking Industry: What Went Wrong and the Way Forward" Speech at Bayero University Kano Convocation Lecture, Feb 26 2010: http://www.cenbank.org/out/speeches/2010/the%20nigerian%20banking%20industry%20what%20went%20wrong%20and%20the%20way%20forwar d_final_260210.pdf accessed 1/11/11

[29] Nigerian Banking Bailout and the Anatomy of Toxic Debt: http//newafricanpress.com/2011/05/29 accessed 25/10/11

VIII. Integrity and Financial Sector Stability

Integrity connotes ideals of fairness, honesty and fair play. An effective system of corporate governance in banks and financial institutions will impose appropriate standards of conduct on managers with effective control and monitoring procedures on banks in order to maximize opportunities for legitimate profits subject to the best interests of depositors and shareholders. Good corporate governance regulates the relationships between banks' stakeholders, their Boards and management. It prevents the abuse of power and self-serving conduct, as well as imprudent and high risk behavior by bank managers, and resolves conflicts of interests between managers and board members on the one hand and shareholders and depositors on the other.

In Nigeria there are four codes of corporate governance being implemented by the Security and Exchange Commission (SEC), the CBN, the National Insurance Commission (NAICOM) and the National Pension Commission (PENCOM). Central to these codes are issues of honesty, fairness, accountability, transparency, performance orientation and commitment to the organisation. The Codes impose both standards of conduct for managers and appropriate procedures for internal controls in order to maximise opportunities for legitimate profits subject to the best interests of stakeholders

In order to enhance the integrity of the financial markets the G20 suggest that there must be commitment to:

- bolstering investor and consumers' protection;
- avoidance of conflict of interest;
- prevention of illegal market manipulation, fraudulent activities and abuse;
- protection against illicit finance risks arising from non-cooperative jurisdictions; and
- promotion of information sharing.[30]

It should be stated that integrity in governance either economic or political is not just the presence of rules and regulations, stipulating appropriate behaviour, but a commitment by all concerned to abide and play by those rules. It requires honest, transparent actions and not lip service. Its goal is to impact positively on the entire system.

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[30] Ibid

Recent revelations in Nigeria's financial system indicated an abject lack of integrity. It can only be said that reports of phenomenal growth regarding these institutions were the result of unproductive activities and manipulation of books and figures. Rating agencies form a part of the charade. In 2007, Fitch rated 7 Nigerian banks amongst 1000 banks in the world, yet in May 2008, JP Morgan issued a report, which warned that the top seven banks, with a combined market capital of over US$40 billion, might be overvalued by as much as 56 per cent[31].

It has been noted that "Substantial amounts of money claimed by these financial institutions is unreal, with the manipulation of the financial records, irresponsible shoring up of share prices, without any genuine link to the real performance of the companies owning these shares."[32] These are clear failures of integrity. Thus, for the on-going reforms to yield results players must imbibe the principles of transparency, accountability and integrity. There should also be efforts to produce money from productive activities entailing applying labour and resources to wealth creation rather than manipulating the system for quick profit.

Without integrity, bailout funds are likely to be a waste of scarce and valuable public assets and resources. Questions are already being asked on how banks are applying bailout funds. According to Kazeem:

> "The bail-out funds handed out to the banks by this regime will never go into anything productive, but rather prepare a catastrophic ground for more disastrous economic woe. We are already witnessing where tax payers money given to the banks is going. Bankers are now using these funds for speculative purposes on foreign exchange.

IX. Conclusion

The global financial crises/Nigerian crisis has raised queries as to the efficacy of regulation and especially the efficiency of financial regulators. By section 13 of the BOFIA, a bank shall maintain at all times, capital funds unimpaired by losses in such ratio to all or any assets or to all liabilities or to both assets and liabilities as would be stipulated by the CBN. This is required in preventing indefinite lending, when at the threshold a bank cannot extend another loan without acquiring

[31] Ola Kazeem: Nigeria Financial Crisis Any way out? http://www.marxist.com/ in defence of Marxism accessed 31/ 10/11
[32] ibid

further capital on its balance sheet. If the CBN was alert to this provision, one should ask how ailing banks acquired such huge debts on their balance sheets. One should also ask what happened to reserve requirements provisions of sections 15 and 16 of the BOFIA as well as Section 45 of the central bank Act. Imposing reserve requirements has traditionally been used by Central Banks as a means of monetary control and maintaining financial stability.

Another matter of concern is why several banks were exposed to the same debtors despite the Central Bank's established Credit Risk Management System (CRMS). Through this system CBN is to obtain returns from deposit money banks on all credit of one million naira and above for compilation and dissemination to any interested party. This enables deposit money banks to know the risk exposure of their clients and helps them to avoid risky business.

The Nigerian society's penchant for responding to the influence of personalities as opposed to the influence of institutions remains a threat to future financial stability. As long as there remain personalities bigger than the system, either notionally, practically or politically, the system will always be prone to instability without exogenous factors and the integrity of the regulator will be called to question. Furthermore, whatever reforms the CBN initiates to address the impact of the global financial crisis must be anticipatory of changes in international financial law in a way that does not result in frequent reversal of policy.

Current developments in the financial services sector have also led to questions on how wide is the financial services sector bearing in mind that many ignorant players assumed that a crisis in the capital market ought not impact banks in the way that we have seen. The question has been who ought to have acted first and how far and wide ought the action to have been?

These lapses may not be entirely the fault of the regulatory authority or that of actors in the sector but a reflection of larger ideological and cultural realities in Nigeria. As observed by Justin O'Brien[33] "There is a dynamic interplay between the culpability of individual actors and the cultural and ideological factors that, not only tacitly condone, but also actively encourage, the elevation of short-term considerations over longer-term interests"

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[33] The Future of Financial Regulatio:Enhancing Integrity through Design Sydney Law Review vol. 32 2010 p65 http://sydney.edu.au/law/slr/slr_32/slr32_1/OBrien.pdf accessed 31/ 10/ 11

Following the financial sector crises of the 1990s around the world and the current global crisis, international efforts have focused on the causes of the crises, their solutions, and prevention of future crises. Attention has also increasingly turned to the role of institutions in economic development, with recent research suggesting that institutions may in fact be the most significant factor. Regulatory institutions especially must be built on principles of transparency and accountability and integrity firmly entrenched on the rule of law.

There is a need, therefore, in Nigeria to go beyond just stipulating rules of behaviour or code of conduct, but to "evaluate how these rules and principles are interpreted within specific corporate, professional epistemic communities and how these influence and are influenced by regulatory practice".

Transparency in information sharing is also critical. The G20 transparency principle anticipates enhanced disclosure rules on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. The Declaration[34] requires the following:

- "The key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard.

- "Regulators, supervisors, and accounting standard setters, as appropriate, should work with each other and the private sector on an on-going basis to ensure consistent application and enforcement of high-quality accounting standards.
- "Financial institutions should provide enhanced risk disclosures in their reporting and disclose all losses on an ongoing basis, consistent with international best practice, as appropriate. Regulators should work to ensure that a financial institution's financial statements include a complete, accurate, and timely picture of the firm's activities (including off-balance sheet activities) and are reported on a consistent and regular basis."

Implementing these standards with other reforms will greatly improve the desire for good governance and transparency in the regulation of Nigeria's financial services sector.

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[34] Summit on Financial Markets and the World Economy : http://www.canadainternational.gc.ca/g20/summit-sommet/g20/declaration_111508.aspx?view=d accessed 31/10/11

Financing Infrastructure and Growth – Lessons and Experience

Engineer Mansur Ahmed*

I. Introduction

Infrastructure forms the foundation for all development in a country. Inadequate infrastructure restricts productivity and limits competitiveness. A 2008 Infrastructure Consortium for Africa (ICA) study identified the dearth of infrastructure, amongst many other constraints, as responsible for Nigeria's low level of performance in all the key economic performance variables. Indeed, Nigeria's diminished competitiveness (127 of 142)[1] could be directly attributed to the abysmal level of infrastructure development in the country. Nigeria's stock of basic infrastructure falls far short of the minimum required for meeting the demands of a 21st-century global economy.

The paper would address the issue of finance for infrastructure, the adequacy or otherwise of the traditional annuall budgetary allocation, and alternative methods for funding infrastructure. The potentials of the stockmarket in filling the financing gap, option of Public Private Partnership (PPP) arrangement in upscaling our infrastructure will be examined. The paper covers an assessment of the merits and demerits of PPP, the PPP process and framework in Nigeria, and how Nigeria could benefit from the experiences of other jurisdictions.

II. Financing Infrastructure and Growth

Traditionally, governments have been the sole financier of infrastructure projects and have often taken responsibility for implementation, operations and maintenance. The national budgets have, therefore, been the principal sources of financing infrastructure development. In Nigeria, it is the norm to wait for a capital infusion through the budget to rehabilitate or replace, rather than maintain the infrastructure. However, declining financial resources is making this option less feasible, thereby accelerating infrastructure deterioration.

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[1] Global Competitiveness Report 2011 - 2012

A recent study[2] of the Federal Government of Nigeria identified the absence of integrated national planning framework for infrastructure delivery, lack of proper project preparation, dearth of capacity in public authorities and inappropriate funding mechanism, among other serious challenges, as the major causes of the delivery of suboptimal infrastructure in Nigeria. In particular, those of dearth of long term finance and inappropriate funding methods posed the most overwhelming challenge. In aggregate terms, the annual budget, which hitherto provided the funding for infrastructure in Nigeria has not only proved completely inadequate. This financing method might indeed be partly responsible for the dismal state of infrastructure in the country. The drip-feeding of projects by the annual budget, whereby limited funds available through the budget for capital works is spread across a large number of projects with the result that most are abandoned, few are completed often at multiples of the original cost and at scandalous extension in the completion time. It also has the greater potential for corrupt practices and ,increased expenditure on public infrastructure, which does not translate to increased stock of capital assets.

III. Alternatives for Funding Infrastructure

Financing for day-to-day manufacturing, expansion and modernization projects usually embarked on by companies, significantly differ from the financing of infrastructure projects in many ways. The financing requirement for a large infrastructure project with lengthy construction periods and productive life, huge initial financial outlay, high project risk and low real return to investment can hardly be met by traditional budgetary financing or corporate financing. The usage of a 25-year loan to fund a project company has a limited appeal for a commercial bank that will prefer shorter term lending at much higher rates. Financing infrastructure projects from direct budgetary allocation has also proved equally unsatisfactory.

However, infrastructure development financing methods have constantly been evolving to meet requirement from initial feasibility and project initiation financing, through construction and longer terms operations. The approach that have recently been encountered in international project finance include monetary grants, venture capital and infrastructure funds, non-recourse or

[2] Alternative funding Sources for Capital Projects: Report of the Technical Working Group on Infrastructure of the Nigerian Economic Management Team.

project finance, equity financing, debt financing, export credit finance, public finance and bond funding, project bond, guarantees or credit enhancement programs, non-monetary grants and joint ventures, and public private partnerships. But for the constraint of time and space, we will henceforth focus our discussion on the capital market instruments and PPPs.

IV. The Capital Market

The capital market in Nigeria is well positioned to fill the resource gap created by the limitations of the traditional budgetary allocation. It could do this through the issuance of some medium to longer term instruments such as bonds, long-term corporate/commercial bonds, infrastructure bonds or such other instruments of longer term maturities as would provide suitable funding for infrastructure projects. The proceeds could then be applied for the development of critical infrastructure. For instance, Development Finance Institutions (DFI), such as the Bank of Industry could issue bonds on behalf of Federal Government of Nigeria (FGN) and directly lend to banks to finance projects. The FGN takes credit risk while banks bear the project risks, and bondholders do not take any credit or project risks. On the other hand, DFIs could issue bond with the FGN or the Central Bank of Nigeria (CBN) guarantee and lend directly to project executors. Here, the FGN or the CBN takes credit risk and DFIs bear project/performance risk. Another variant would be where a Consortium of Banks issue bond with CBN guarantee and lend directly to project executors, with the FGN or CBN bearing the credit risk, while the consortium of banks bear project/performance risks.

Indeed, the FGN, through the CBN has already taken a number of steps previously to provide access to funding at concessional rates and to galvanize private sector interest in the power and agriculture sectors. For instance, under the ₦500 billion Real Sector Intervention Fund, the CBN has invested ₦500 billion in debentures issued by the Bank of Industry (BOI), the proceeds of which are for on-lending through deposit money banks (DMBs) to qualified borrowers at concessional interest rate of not more than 7 per cent, and for tenors of 10-15 years. The target borrowers are those from the power, small-scale manufacturing and airline sectors that meet well-defined eligibility criteria, power projects of the State and Federal Governments are covered under this facility subject to their being as commercially viable on which banks are willing to take credit risk.

The major concern here is not so much of the ability of capital market in providing long-term capital for infrastructure development, but breadth and depth of such intervention. Apart from the limited absorptive capacity of the domestic capital market, and the rising FGN Yield Curve, there is the limitation placed on domestic borrowing by the Fiscal Responsibility Act 2007. Section 4.1(1) (a) provides only for concessional borrowing by all tiers of government, except in special cases where approval would need to be sought from the National Assembly. It is my submission that the current dismal state of the Nigeria's infrastructure provides a special case for the intervention of the National Assembly.

In addition, the limited absorptive capacity of the domestic capital market could be improved through harnessing the pension funds in Nigeria, which currently stands at over $12 billion with an increase of 30 per cent annually. Due to their long maturities, stable earnings and diversification, pension funds are suitable and tailor-made for infrastructure development. The limitation here appear to be that investment can only be in structured and regulated instruments that are rated and possibly listed on a recognized exchange to mitigate risks. In addition, the securities should have clear maturity, and periodic/terminal payout. This is an area the National Assembly can assist through appropriate expedited legislation to make infrastructure a separate asset class with specific asset allocation. Such other reform programs as the tax waiver granted corporations and sub-nationals in March 2010 to facilitate more investments in the capital markets, and the policy reform in the insurance industry, would further inject more investments in the capital market.

V. Public Private Partnership (PPP)

According to KPMG, PPPs involve "*The design, build, finance and operate, by the private sector, of assets and services that the government has traditionally procured and provided to the community and which have previously been funded by taxpayers. In return, the private sector generates revenue either from the levying of tariffs on users or the receipt of periodic service payments from the government over the life of the PPP agreement*"

It is, therefore, a co-operative venture for the provision of infrastructure or services, built on the expertise of each partner that best meets clearly defined public needs, through the most appropriate allocation of resources, risks, and rewards. The public sector maintains ownership, oversight and quality assessment role, while the private sector is more closely involved in the actual delivery of the service or project. This has become the method of choice by governments throughout the world for scaling-up infrastructure and providing goods and services for their economies. In industrialised economies, there is a growing commoditisation and privatisation of public services, undertaken through the establishment of public private partnerships. This is for a very good reason. Besides filling the resource gap in project delivery and operation, PPP arrangements do engender acceleration of project delivery, promote faster implementation of projects, and reduced whole life costs of project. Besides, it offers better risk allocation between public and private sectors, offers better and sustainable incentive to perform, engender accountability in fund utilisation, and improve the overall quality of service. Evidence abound that it leads to the generation of additional revenue and overall value for money for the economy.

A typical private partner consists of a design company, construction contractor, facility management operator, maintenance company, debt provider and third-party equity investors, constituted into a SPV/E. The private partner is also known as Project Company, consortium, concessionaire or contractor.

VI. The Nigerian PPP Framework

The Infrastructure Concession Regulatory Commission (ICRC) was inaugurated in November 2008 as a way of addressing the huge infrastructure deficit in Nigeria and the decrepit state of the existing infrastructure. The Act, which established the Infrastructure Concession Regulatory Commission (ICRC), also empowers Federal Ministries, Departments and Agencies (MDAs) to utilise Public Private Partnerships (PPP) as a procurement vehicle of choice, where suitable, to rapidly turn around the country's infrastructural inadequacy. The Act envisages the ICRC to serve as the primary driver agency to catalyse and facilitate engagement of the private sector by Ministries, Departments and Agencies (MDAs) of the Federal Government in initiating, developing and implementing PPP projects in a fit-for-purpose, transparent, competitive and sustainable manner that would ensure value for money for the Nigerian economy, while putting in place world-class infrastructure for use by Nigerians. The Commission also has the additional task of creating an enabling environment for the private sector to enter into partnerships with Government in the financing, operation and management of infrastructure and allied services.

Since inauguration, the Commission has developed the National Policy on PPP (N4P) and associated operational guidelines, which provide best practice guidelines and procedures for the effective development and competitive procurement of PPP projects. In carrying out its mandate, ICRC has worked closely with MDAs of states in the process of building and regulating a world-class and internationally competitive PPP market in Nigeria. Currently, there are 20 projects that this engagement will be bringing into the market by 2012. In accordance with its mandate, the Commission has taken custody of and reviewed some major concessions entered into by the Federal Government before its inauguration. It has developed a robust database of concessions already entered into by the FGN through the MDAs. In addition, ICRC has established a framework for addressing the complex issues arising from these "legacy concessions", and has intervened in a number of disputes between the MDAs and their private sector partners with a view to getting the parties to negotiate a mutually acceptable resolution.

Other areas that the Commission has recorded considerable successes include promoting the development of funding sources and instruments with long tenor for financing infrastructure projects in the country. ICRC is also working with the national planning authorities to integrate infrastructure provision into the national planning framework as sustainable infrastructure development must be anchored on a coherent and consistent economic planning framework. Furthermore, in close collaboration with the National Planning Commission (NPC), priority projects have been fully incorporated in the National Implementation Plan of Vision 20:2020.

Although the ICRC Act limits the Commission's jurisdiction to federal projects, the Board recognises that aligning the states' PPP framework with the federal framework will be an important pre-condition for the development of a coherent and robust national PPP market in Nigeria. It is likely to deepen the capacity of PPP practitioners in the country and enhance the attractiveness of the Nigerian projects in an increasingly competitive global PPP market. Thus, the ICRC, established collaborative relationship with the PPP agencies in Lagos, Cross River, Niger, Benue, Rivers, Kaduna and Bayelsa states and will continue to encourage such linkages with other states and assist them when required to establish or strengthen their PPP institutions.

The efforts have not been without some challenges. Getting the MDAs and the private sector partners to abide by the new PPP Policy Guidelines has been a great challenge. In collaboration with the office of the Head of the Civil Service of the Federation, the Commission is currently championing the establishment of PPP Units in key infrastructure MDAs. Conceptually, these PPP Units will become and remain the reservoir of institutional knowledge for PPPs in the MDAs.

VII. Experiences from Other Jurisdictions

Driving infrastructure development, notably mobilising financial resources for infrastructure projects, has been challenging in many countries. Many countries have mobilised resources to finance in infrastructure in different ways.

BRAZIL

The infrastructure base of Brazil was built through funding from the stock market and through PPPs. This was made possible by a relatively sophisticated financial sector, with a large banking sector including some banks with extensive foreign operations. Derivatives markets, particularly for foreign currency, are also well developed. The stock market, with total capitalisation around ¾ of GDP[3], has grown dramatically in recent years. Recognising private sector constraints on infrastructure investment, particularly given the run-up to Brazil's hosting of the World Cup in 2014 (and now of the Olympics two years later), the Brazilian government in 2007 created the Growth Acceleration Program (PAC for its initials in Portuguese). The program, aimed at increasing growth and reducing poverty, requires US$251 billion in additional infrastructure and other investment over four years, to be financed by the government (US$34 billion) as well as public enterprises and the private sector. Among other measures, it exempts from some federal taxation certain capital and primary goods related to infrastructure investment and construction, and will eventually create a tax-exempt National Investment Fund to finance infrastructure projects.

Long-term lending tends to come from the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), a publicly-owned development bank. BNDES not only provides loans directly to companies investing in infrastructure, but also provides guarantees and securities underwriting, and itself buys bonds placed by some companies. BNDES secures financing from retained earnings and some

[3] Financing Infrastructure in India: Macroeconomic Lessons and Emerging Market. Case Studies. James P. Walsh, Chanho Park and Jiangyan Y. August 2011

foreign funding (including from bilateral and multilateral lenders), but also from various tax and workers' funds and, in recent years, debt issued under the auspices of the Brazilian government.

CHILE

Chile experience with infrastructure development is perhaps, one of the best examples for private investment in infrastructure[4]. This is, perhaps due to its macroeconomic and political stability, it is extremely well-developed e-government services, clear information on policy changes, transparency and openness of statistics publications, and dialogue and decision-making process. In 2010, WEF[5] report on private infrastructure financing in Latin America gave it the top ranking above any other country in the region.

Chile ranked 49th in the world in the World Bank's 2010 Doing Business Report, and was rated above average for starting a foreign business in the *Investing Across Borders Report*. The financial sector, which has developed in tandem with Chile's privatised pension system, is relatively well developed, with a stock market capitalisation of around 144 percent of GDP, a reasonably well developed corporate bond market, and a liquid market in interest rate derivatives.

Following privatisation of the public sector in 1981, workers were given 'recognition bonds' proportional to their contributions to the public system, and opened accounts in the new investment firms, called AFPs, upon which a proportion of their salaries was deposited each month. Contributions to pension funds are made automatically. AFPs charge management fees in exchange for investing clients' funds and provide regular reports on performance. Upon retirement, regulations do not allow workers to take lump-sum payouts: a substantial portion of the account must be turned into an annuity, which is indexed to inflation. This annuity requirement, in turn, has led to substantial growth in Chile's insurance industry, which until the 2007 pension reform was effectively used in the administration of the country's retirement program. These funds formed the capital base for the country's infrastructure development.

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[4] A 2010 World Economic Forum report

[5] World Economic Forum

SOUTH KOREA

Infrastructure investment has been a crucial component of Korea's long standing export- driven growth strategy. During the 1960s, infrastructure investment accounted for about one third of gross fixed capital formation. In the past, Korea's financial system was poorly developed, so infrastructure finance was heavily dependent on public and foreign sources. Though infrastructure investment declined as a share of total investment since then, during the 2000s, infrastructure still accounted for 11 per cent of gross investment.

In the 1990s, as financial sophistication increased, the Korean government took measures to increase private participation in infrastructure, though this was initially limited in size and sectoral coverage. Some of the measures included partial VAT rebates when facilities were completed, capped public guarantees, early completion bonuses and permission for excess profit resulting from lower than expected construction costs, and compensation for certain losses such as those due to exchange rate movements. This program was successful and the ratio of private to public investment in infrastructure increased to 18.4 percent in 2008.

The government later allowed the creation of private equity infrastructure funds. These funds were intended to support further private investment in infrastructure and improve the pool of management and operation skills by encouraging more active project management. These funds allow investors to provide equity to green field infrastructure projects as well as through recycling equity currently tied up in near-complete or operating infrastructure projects. One of the largest currently in operation, the Macquarie Korean Infrastructure Fund (KIF), has around US$ 1.7 billion under management, and is listed in Seoul and London. Institutional investors comprise 62 percent of shareholders, with domestic (12 percent) and foreign retail (26 percent) investors holding the remaining shares

VIII. Lessons from Nigeria's PPP Experiences

In the course of developing viable PPP projects that would attract credible investors and financiers with MDAs, we have learnt from the experiences of other emerging countries like India, South Africa and Malaysia that have adopted sound PPP frameworks to significantly scale-up their national infrastructure.

First, PPP projects that have been most successful the world over, have been characterised by thorough planning, detailed studies and analyses of lifecycle costs and revenues, good communication, strong commitment from all parties and are guided by open and transparent procedures. These procedures commence with proper project preparation and clarity in the specification of output requirements. The conduct of a thorough needs analysis of the service to be delivered and a careful consideration of all available options for delivering the service should be the first necessary steps. This must be determined by a thorough feasibility study that must also test the affordability and value-for-money of the project. It is necessary to identify all potential risks that may threaten the success of the project and determine, which party in the partnership would bear which risks. This would ensure that the rewards conferred on partners are commensurate with the risks they bear. It is also important to consider all relevant stakeholders, including communities, labour and the environment, whose interests may be affected by the project and ensure that all key stakeholders' interests are adequately addressed. Finally, in selecting private sector partners, it is imperative that an open and competitive procurement procedure is followed. The important lessons from these, are that successful PPP projects require a significant investment in time and resources to prepare an open and competitive procurement process will more likely ensure selection of the right partners.

Second, PPP projects that are selected from a coherent infrastructure investment programme, which is an integral part of a national development plan tend to add greater value to and enhance overall national development more than projects that are conceived by private proponents outside the national plan and proposed to the public sector as unsolicited projects. Thus, it is preferable that unsolicited projects be the exception rather than the rule and where such unsolicited projects are found acceptable, they must be subjected to a thorough review and analysis to ensure that they are consistent with the national plan. Further, they must also be subjected to same tests as internally-generated projects with regards to affordability, value-for-money, risk/reward balance and competitiveness.

Third, PPP contract agreements involve long-term commitments. They are also complex, often involving many parties and significant risks. They must, therefore, be approached with great care, due diligence and a deep sense of responsibility and accountability, especially on the part of public sector officials who must recognize that they are acting under public trust. This is particularly pertinent, since officials involved in negotiating a particular contract are no longer in service when the agreements begin to fall into dispute. It is also important that senior public functionaries should endeavour to refrain from undue interference in contractual negotiations between public officials and their private sector partners. Such interference often makes it difficult to hold public officers accountable for any failed contracts.

Finally, PPP arrangements involving long-term relationships (10 to 30 years), must be approached by both partners with absolute seriousness. This is because despite every effort to plan and prepare these projects professionally and analyze potential risks, it will not always be possible to anticipate all risks or mitigate them effectively. It is, therefore, imperative that both parties approach the contract with a spirit of genuine partnership, a commitment to work for a win-win situation and to always seek an outcome that ensures that the interests of all parties are recognized and pursued in an equitable manner. This requires a level of openness and transparency in negotiations in which there is full disclosure and sharing of information and concerns. It also requires high level of professional competence and skills in all aspects of the transaction: technical, legal, financial, among others. Thus, this indicates the need for public sector agency to engage competent and experienced transaction advisers.

While the foregoing lessons have all been fully incorporated in the National PPP Policy and guidelines, the experience in the past years clearly indicate an urgent need for MDAs and private sector partners, to recognize and imbibe these lessons PPP is to be used to attract significant private sector investment in scaling up infrastructure in the country. First, it is absolutely vital that all PPP projects be developed and procured in line with the National Policy on PPP (N4P) and MDAs are encouraged to consult ICRC at the earliest stages for necessary guidance and support. It is also important that MDAs make adequate provisions in their annual budgets for the cost of project development which should be in the range of 3 – 5 per cent of the estimated project cost. Further, MDAs are advised to consult the Commission with regards to all unsolicited projects, which they consider of interest before engaging the proponents for further discussions or make any commitments.

IX. Conclusion

Undoubtedly, Nigeria's infrastructure deficit has stymied its economic growth, restricted productivity and limited its competitiveness. It has impacted negatively on the cost of doing business, investment and capital inflow into the country. The domestic financial markets, which are largely rudimentary, exhibit paucity of long term finance, and compel reliance on government resources for funding infrastructure. This development leads to repeated cycle of underperformance and continued deterioration of existing infrastructure.

Indeed, the private sector has large pools of resources from which they can seek funding, which governments may not have access to, or the capacity to access, including both local and international financial markets. As a result, private sector involvement in infrastructure provision has been widely considered and implemented as a preferred method of financing infrastructure provision globally. Governments all over the world have come to recognize that the collaboration between public and private sectors is crucial to securing dependable and sustainable funding for infrastructure and reducing the pressure on fiscal budgets. Perhaps, it was in realization of this global trend that the Federal Government of Nigeria recently enacted the Infrastructure Concession Regulatory Commission Act 2005, to provide the framework for private sector participation in the provision of public infrastructure.

The infrastructure market in Nigeria is vast and wholly undeveloped and unexploited. The sectors that PPP initiatives are likely to play a significant role include roads and highways, light railways, ports, airports, dams, bridges and tunnels. Others are electricity, oil and gas pipelines, water and sanitation and telecommunications sub-sectors.

The financial sector including the capital market could contribute by exploring the emerging opportunity as either debt funders or equity funders for infrastructure development and operation. Opportunities also exist in the provision of PPP advisory services to the public sector agencies or the special purpose entities created by the private sector to deliver infrastructure. Attractive returns in the form of fee for PPP consultancy services, interest charges on debt, commissions and profits are available to those who identify this emerging opportunity and take advantage of it. In particular, banks, pension funds, corporations, insurance companies, the capital market, high net worth individuals and others who could move in early will invariably dominate the market and determine the ground rules for others to follow.

The Central Bank of Nigeria and Its Developmental Functions: A Review of Current Initiatives

*Cajetan M. Anyanwu**

I. Introduction

Government in any economy plays a central role in shaping the operation of the financial system and the degree to which the range of financial services is expanded and made available to a broader set of households, firms and sectors in the economy (Demirguc-Kunt and Levine, 2008). Specifically, the degree of political and macroeconomic stability and the operation of legal, regulatory and information systems all influence the financial environment. The role of shaping the financial landscape of an economy to promote growth is vested with the central bank, in the case of Nigeria, the Central Bank of Nigeria (CBN).

The function of central banks include the maintenance of price stability, issuance of legal tender, management of the external reserve to stabilize the exchange rate and promoting sound financial system and stability. Central banks also engage in developmental functions through the focus on real sector activities and growth

The financial systems of developing countries are narrow and shallow. They hardly provide adequate financing for real sector activities. Also, the market may not perform efficiently in the allocation of financial resources and the priority sectors of the economy may experience poor funding. Under these circumstances, the central bank may come up with special funding schemes and facilities that would address the needs of the sectors that ordinarily would not be accommodated by the banks. This role is classified as a developmental function. Such developmental activities include credit guarantees and insurance; promotion of the capital market and development finance institutions; priority sector lending, preferential interest rates to priority sectors, preferential rediscount rates and facilities and setting target credit/deposit ratios for rural branches of banking institutions.

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II. The Central Bank of Nigeria (CBN) and National Economic Development

II.1 The Mandates of the Central Bank of Nigeria

In line with the traditional functions of the central bank, the mandates of the Central Bank of Nigeria as contained in the CBN Act 2007 amended are to:

- Ensure monetary and price stability;
- Issue legal tender currency in Nigeria;
- Maintain external reserves to safeguard the international value of the legal tender currency;
- Promote a sound financial system in Nigeria; and
- Act as banker and provide economic and financial advice to the Federal Government of Nigeria.

But like most central banks in the developing world, the CBN has developmental functions which it has performed over the years. These developmental roles have been targeted mainly at promoting the real sector of the economy, especially agriculture and manufacturing.

II.2 The Central Bank of Nigeria and National Economic Development

The Central Bank of Nigeria impacts on national economic development through the discharge of its mandates and the promotion of some developmental functions.

(a) Ensuring Monetary and Price Stability

Ensuring monetary and price stability is one way through which the CBN impacts positively on national economic development. This mandate is intended to achieve stable prices and low inflation. It is achieved through the design and implementation of sound monetary policy, which is recognised as the most important function of the central bank. Monetary policy is defined as a combination of measures, designed by the monetary authority, to regulate the value, supply and cost of credit in an economy, in consonance with the estimated level of economic activity. The goal of monetary policy is to achieve price stability. Price stability or low inflation helps in the achievement of other macroeconomic objectives, such as growth in output and reduction in unemployment. Empirical evidence has shown that an environment with relatively stable prices promotes macroeconomic stability, aids planning, encourages savings and investments, promotes higher standard of living and reduces poverty.

In view of this, the CBN has, over the years, committed huge resources to control inflation, mainly through the open market operations. In the last ten years, therefore, the year – on – year inflation moderated, falling to single digit in 2006 and 2007, and averaged 13.0 percent for the decade, compared with an average of 31.2 percent in the previous decade. Thus, the CBN's effort to achieve low inflation last decade was relatively successful. The quantum of credit that could be made available to the private sector is also determined by a monetary programme which the monetary authority adopts. In turn, credit availability determines the volume of investment the economy can achieve. Credit to the private sector has grown over the years, especially during the post consolidation era, though there was a decline in credit growth rate in 2009 and 2010. But interest rate remained high, as the maximum lending rate fluctuated around 20.0 percent, which may not have been investment friendly.

(b) Management of External Reserves

During the review period, the economy recorded remarkable improvements in the management of the external reserves. The CBN introduced the Dutch Auction System (DAS) to strengthen the foreign exchange management. The Bank and the fiscal authorities were also committed to the crude oil price-based budgeting system that allowed for oil export receipts above the specified budget price to be saved in an account in the CBN rather than being shared by the three tiers of government. Thus, there was a deliberate effort to build reserves. This policy has been given legal backing recently through the promulgation of the Sovereign Wealth Fund Act, 2011. Furthermore, to enhance the efficiency and effectiveness of reserves management, the CBN introduced the innovation of involving domestic banks in external reserves management. These measures were also supported by the phenomenal increase in crude oil prices in the international oil market, which boosted the external reserves.

Thus, the stock of external reserves, which stood at US$5.0 billion in May 1999, rose to US$10.3 billion in December 2001, and peaked at US$51.3 billion in 2008. However, the reserves declined to US$42.4 billion in 2009 and further to US$32.3 billion in 2010, due to the huge drawdown made to finance balance of payments deficits during the two years. As at December 2010 the reserves could finance over 7 months of imports, compared with the minimum three months of imports requirement. Building of high levels of reserves reflects the strength of the economy vis-a-vis the rest of the world. Also, the exchange rate was relatively stable, depreciating from ₦112.49/US$ in 2001 to ₦150.7/U$ in 2010.

(c) Issue of Legal Tender Currency and Improved Payments System

The architecture of the payments system was strengthened in 2004, with the introduction of a new clearing and settlement arrangement, comprised designated settlement banks. This replaced the old system in which the CBN organised and supervised inter-bank settlements. Other initiatives undertaken to strengthen the payments system include:

- Issuance of a new ₦100, ₦200, ₦500 and ₦1,000 legal tender currency notes, which reduced substantially the cost of currency issue and administration and the volume of currency notes;
- Sustained automation of the clearing system; and
- Introduction of electronic money (e-money), smart cards, and the development of the Real Time Gross Settlement (RTG) system to deal with large value payments and settlements, as well as innovative money transfer arrangements.

Effort at reducing the clearing cycle to T+2 yielded positive results with the introduction of the Nigeria Automated Clearing System (NACS), which significantly increased the level of activities in the banking system and restored confidence in the use of cheques. The net result, is that the speed of financial transactions has increased and the clearing time for cheques for the banks that are fully automated, reduced considerably. All these have transformed the payments system, reduced the use of cash and promoted trade generally.

(d) Banking Sector Reforms

The current major reforms which began in 2004 were necessitated by the need to strengthen the banks. At the inception of the reforms, the thrust of policy was to grow the banks and position them to play pivotal roles in driving development in all the sectors of the economy, as well as induce improvements in their own operational efficiency. As a result, banks were consolidated through mergers and acquisitions, raising the capital base from ₦2 billion to a minimum of ₦25 billion, which reduced the number of banks, from 89 to 25 in 2005 and to 24, thereafter. Beyond the need to recapitalise the banks, the reforms focused on ensuring minimal reliance on public sector for funds, but rather relying on the private sector. Also, the CBN adopted risk focused and rule-based regulatory framework; zero tolerance in regulatory framework in data/information rendition/reporting and infractions; strict enforcement of corporate governance principles in banking; expeditious process for rendition of returns by banks and other financial institutions through e-FASS; revision and updating of relevant laws for effective corporate governance; and greater transparency and accountability in the implementation of banking laws and regulation.

In spite of the positive outcome of the reforms, a new set of problems emerged and threatened the financial system from 2008, coinciding with the global financial crisis (Sanusi, 2010). The surge in capital put pressure on available human capacity in the sector and this led to accumulation of margin loans and other high risk investments, especially in the capital market and the oil and gas sector. Consequently, when the capital market bubble burst, the balance sheet of many banks became eroded to the extent that some remained for some time on 'life support' from the CBN. Interbank rates spiked as banks could borrow at any rate in order to remain afloat, the size of non-performing loans enlarged, customer panic re-emerged and several unethical conducts among the managements of banks were revealed. These developments set the stage for another round of reforms which are currently being implemented.

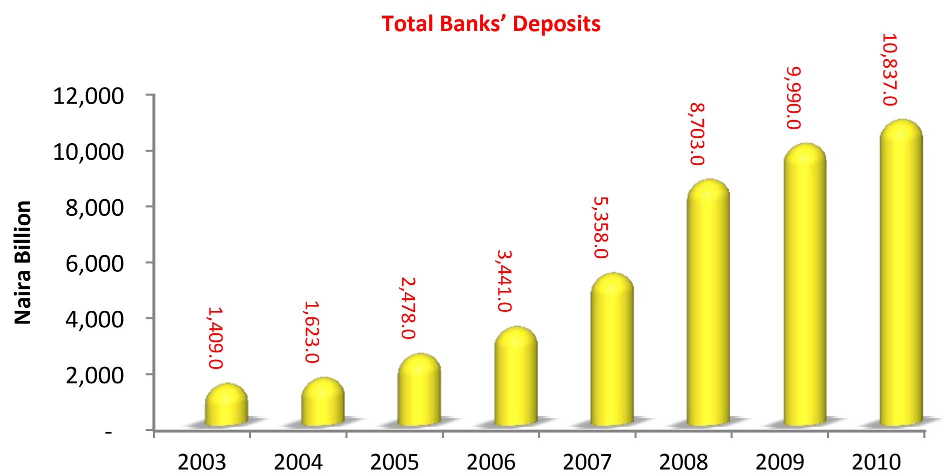
The current reforms could be broadly divided into two. The first part focused on ensuring that the nine banks, which examination revealed were in poor state, were rescued. Some of the actions taken by the CBN included reduction of cash and liquidity ratios, expanded discount window operations, which enabled the banks to borrow for up to 360 days from the CBN. It also admitted non-traditional instruments, like commercial papers, promissory notes and bankers' acceptances in the discount window. Interbank lending was also guaranteed to encourage banks to lend among themselves. The sum of ₦620 billion was injected into eight of the weak banks in direct rescue packages, while corporate governance was enforced with the appointment of new management teams for the affected banks. Over all, the system has been restored to the path of stability.

The second phase of the reforms is couched in terms of medium to long-term objectives. Under this, financial sector stability was emphasised alongside the need to position the banks to provide funding for the development of the real sector of the economy. The four cardinal pillars of the reform were: enhancement of the quality of banks, establishment of financial stability, enablement of a healthy financial sector, and ensures that the financial sector contributed to the real economy.

The fourth pillar of the reform has direct bearing on the development of the real sector as it sought to position the banking system to contribute to the growth and development of the various sectors of the economy. This pillar is anchored on the fact that real economic growth must be supported by actual rise in physical goods and services. This segment of the reform, therefore, sought to break from the classical orthodoxy of leaving the allocation of financial resources entirely to the market forces. Rather, the reform has identified priority sectors and developed tailored interventions to support and promote growth in these sectors. Some of the key interventions are discussed in the next section.

The effects of the overall reform efforts are manifold. First, the larger size of the banks engendered improved customer confidence and deposits increased phenomenally, from ₦2.5 trillion in 2005 to ₦5.4trillion in 2007 and further to N9.9 trillion and N10.8 trillion in 2009 and 2010, respectively.

Figure 1: Total Banks' Deposit (2003 - 2010)



Source: CBN

Second, banks by their increased size were enabled to fund large ticket projects, especially in infrastructure, and oil and gas sectors, through the new window in the enlarged single obligor limit. Credit to the private sector grew significantly from 2007 to 2009, but there was decline in 2010 (Table 1).

Table 1: Credit to Private Sector by Activity (₦' Billion)

Sectors	2003	2004	2005	2006	2007	2008	2009	2010*
Agriculture	62.10	67.74	48.56	49.39	149.58	106.35	135.70	128.41
Min. & Quarry	95.98	131.06	172.53	251.48	490.71	846.94	1,190.73	1,178.10
Manufacturing	294.31	332.11	352.04	445.79	487.58	932.80	993.46	987.64
Communication	293.70	382.76	375.73	500.24	1,158.10	1,304.85	776.58	821.02
Oil & Gas**	229.23	277.53	431.39	586.48	1,266.67	1,943.70	2,116.63	1,984.41
Others	227.89	328.04	610.89	690.92	1,260.85	2,655.75	3,699.04	2,606.86
Total	1,203.20	1,519.24	1,991.15	2,524.30	4,813.49	7,790.40	8,912.14	7,706.43

*Note: * 2010 figures are provisional; ** Oil & Gas figures are estimates from 2008 – 2010*
Source: CBN

The phenomenal growth in credit went to mining and quarrying, oil and gas sub-sectors, as well as to capital market investments. In contrast, the share of agriculture, manufacturing and communications fell substantially (Table 2).

Table 2: Credit to Private Sector by Activity (Per cent)

Sectors	2003	2004	2005	2006	2007	2008	2009	2010*
Agriculture	5.16	4.46	2.44	1.96	3.11	1.37	1.52	1.67
Min. & Quarry	7.98	8.63	8.66	9.96	10.19	10.87	13.36	15.29
Manufacturing	24.46	21.86	17.68	17.66	10.13	11.97	11.15	12.81
Communications	24.41	25.19	18.87	19.82	24.06	16.75	8.71	10.65
Oil & Gas**	19.05	18.27	21.67	23.23	26.32	24.95	23.75	25.75
Others	18.94	21.59	30.68	27.37	26.19	34.09	41.51	33.83

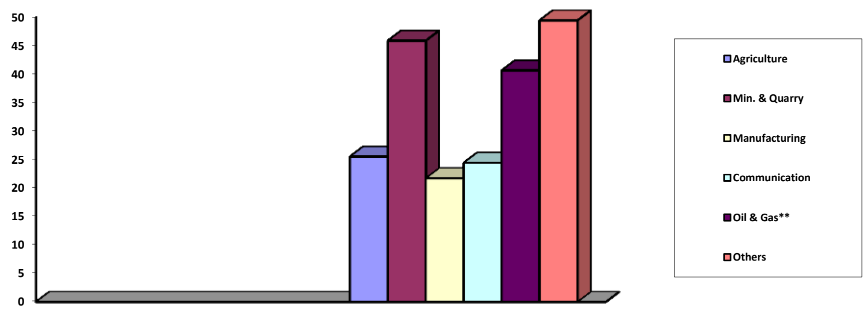
*Note: * 2010 figures are provisional; ** Oil & Gas figures are estimates from 2008 – 2010*
Source: Derived from Table 1

Table 3 shows the percentage change over the years of credit to private sector by activity. On average, credit to mining & quarrying, oil & gas, and 'others' rose by 45.9, 40.7 and 49.5 per cent, respectively. However, the effects were on other sub-sectors, change in credit to agriculture increased by 25.5 per cent; communications, 24.4 per cent; and manufacturing, 21.7 per cent.

Table 3: Credit to Private Sector by Activity (Percentage Change)

Sectors	2004	2005	2006	2007	2008	2009	2010*	Average
Agriculture	9.08	-28.31	1.71	202.85	-28.90	27.60	-5.37	25.52
Min. & Quarry	36.55	31.64	45.76	95.13	72.59	40.59	-1.06	45.89
Manufacturing	12.84	6.00	26.63	9.37	91.31	6.50	-0.59	21.72
Communications	30.32	-1.84	33.14	131.51	12.67	-40.49	5.72	24.43
Oil & Gas**	21.07	55.44	35.95	115.98	53.45	8.90	-6.25	40.65
Others	43.95	86.22	13.10	82.49	110.63	39.28	-29.53	49.45

Figure 2: Average percentage change for each Sector (2004 – 2010) (see RSD).



*Note: * 2010 figures are provisional; ** Oil & Gas figures are estimates from 2008 – 2010*
Source: Derived from Table

Third, although the number of banks reduced by almost four folds, the number of bank branches increased by 80.0 per cent from 3, 247 in 2003 to over 5, 837 in 2010 , while employment in the sector rose from 50, 586 in 2005 to 71, 876 in 2010. Fourth, the capital market received a boost as several banks recorded success in their initial public offers (IPOs). Fifth, the consolidation exercise impacted positively on the payment system as the fewer number of banks made it easier to deploy the new automated clearing systems and also reduced the length of time spent on the clearing floor. Lastly, supervision burden became lighter as the coverage reduced from 89 banks to 24.

(e) Developmental Role

Some interventions were made in other sectors of the economy, to enable the Bank achieve its prime mandate of price stability and contribute to economic development in general. Thus, it promotes real sector activities through the instrumentality of agricultural finance, small and medium enterprises (SME) growth, entrepreneurship development, among others. These are discussed in Section 3.

III. An Overview of the Developmental Role of the Central Bank of Nigeria

The rapid growth experienced in the financial sector over the years did not impact much on the real sector of the economy as envisaged. The various developmental financial institutions set up for specific purposes, such as agricultural finance and industrial promotion, did not achieve the stated objective of promoting growth, as manufacturing production, building and construction, transport, communications, utilities and real estate, taken together, accounted for only 11.2 per cent of Nigeria's gross domestic product (CBN, 2010). But these sectors are the growth drivers in the emerging markets in Asia, Europe and Africa. In contrast, the primary production of agriculture and crude oil contributed as high as 35.6 and 32.7 per cent, respectively.

In the last ten years, the GDP growth has increased remarkably. But at an average of 6.5 per cent, the growth is grossly insufficient to lift a large number of people out of poverty in line with national objectives. Rather a growth rate of 13-15 percent over time would do the magic. Thus, over 50 per cent of Nigerians live below the poverty line, attributed largely to lack of investment capital and access to credit facility in various sectors, poor infrastructure and productive technologies and low capacity to manage resources (CBN,DFD, 2008).

In order to address the challenge of promoting growth in the priority sectors, the CBN collaborates with the government, private organizations, development partners, and other relevant institutions to design and implement schemes that would Improve bank lending for real sector activities, empower small scale entrepreneurs, create employment opportunities and ensure food security, and alleviate poverty.

III.1 Major Developmental Activities of the CBN

The CBN has tried to promote real sector activities through the instrumentality of:

III.1.1 Agricultural Financing

Considerable effort was made by the Bank to strengthen the Agricultural Credit Guarantee Scheme Fund (ACGSF). The ACGSF is jointly funded by the Federal Government and the CBN. The objective of the scheme is to induce banks to participate actively in purveying credit to farmers, given the high risk and neglect of agricultural credit in recent times, coupled with the relative inadequacy of guaranteed loan sizes, in a high cost farming environment. The share capital of the Fund was increased from ₦1.0 billion to ₦3.0 billion in 2001. In 2003, the Board of the ACGSF ratified the participation of fully licensed community banks in the operation of the Scheme, with effect from January 1, 2004. Consequently, loan guarantee limits under the Scheme were raised for all categories of borrowers. As at end 2010, the cumulative loans guaranteed under the scheme from inception in 1978 was 698,200, valued at ₦42.15 billion.

Other developmental functions of the CBN that have impacted positively on the agricultural sector are the Trust Fund Model of the ACGSF and the Interest Drawback Programme.

III.1.2 Financing Small and Medium Enterprises

Over the years, the CBN has established a number of financing schemes designed to promote the growth of small and medium enterprises (SMEs). First, is the direct monetary policy measure of credit allocation to SMEs during the pre-SAP era? During 1966-1996, 20 per cent of total commercial and merchant banks' loans were channelled to the SME and any defaulting bank was sanctioned. Second, the CBN promoted the establishment of development financial institutions (DFIs), jointly with the Federal Government. The DFIs were mandated to make compulsory and concessionary credit to SMEs and other identified sectors. They included the Nigerian Industrial Development Bank (NIDB), established in 1962; the Nigerian Bank for Commerce and Industry (NBCI) (1973); and the Nigeria Export-Import Bank (1991).

Other pro-SME programmes of the Bank included the establishment of the Peoples Bank of Nigeria (1989); securing of the World Bank SME1 Loan Scheme of US$41 million (1984) and World Bank SME II Loan Scheme of US$270 (1990); and the establishment of the Small and Medium Enterprises Equity Investment Scheme (2001).

III.1.3 The Microfinance Policy

The Microfinance Policy Regulatory and Supervisory Framework (MPRSF) for Nigeria was formally launched in 2005. The principal objective of the policy is to establish microfinance banks (MFBs) that are financially sound, stable, self-sustaining and integral to the communities in which they operate. MFBs are expected, as their primary focus, to provide access to financial services on a sustainable basis for the huge market of un-served and vulnerable groups, who otherwise would have no access to financial services from conventional banks and other financial institutions (CBN, 2008).

The policy framework aims to achieve many objectives that are related to uplifting the economic fortunes of the poor. These include, enabling access to credit for the unbanked poor, financial inclusion of the informal economy, smoothening the path of service delivery by microfinance institutions, providing a platform for interaction among formal and informal credit institutions, and ultimately energizing rural transformation. The framework also seeks to ensure that set objectives are consciously pursued and progress monitored, by stipulating targets to be met over the long term.

The targets are expressed in specific terms as follows:

- increasing the share of micro credit in total credit to the economy from 1 per cent in 2005 to 20 per cent by 2020;
- the percentage of micro credit in total Gross Domestic Product (GDP) to rise to 5.0 per cent from 0.2 per cent over the same time period;
- 67.0 per cent of states and local governments to participate in micro credit financing by 2015;
- adjusting the gender equation in business enterprises in favour of women by increasing their access to financial services by 5.0 per cent annually; and
- achieving 10.0 per cent financial integration annually.

There are two categories of MFBs; MFBs licensed to operate as a unit bank with a minimum capital requirement of ₦20 million; and MFBs licensed to operate in a state with a minimum capital requirement of ₦1billion. The two categories can aspire to have national coverage provided they grow organically. MFBs could be owned by individuals, group of individuals, community development associations, and private corporate entities and foreign investors.

The total assets of MFBs had grown progressively since the policy was launched, from ₦55.06 billion in 2006 to ₦158.79 billion in 2009. Net loans and advances also rose to ₦55.823 billion as at end-2009, which was fourfold, the level in 2006. The same trend was observed for the volume of deposits mobilised by MFBs. It rose from ₦34.01 billion in 2006 to ₦72.75 billion at end-2009, an increase of 113.9 per cent. These are indicators of increasing financial intermediation, improved access to financial services and a boost to rural economic activities.

III.1.4 Entrepreneurship Development

The CBN established three Entrepreneurship Development Centres at Onitsha, Lagos and Kano, in partnership with the private sector. They were set up to achieve the following objectives:

- develop entrepreneurship spirit amongst Nigerians
- develop skills of would-be-entrepreneurs to successfully start, expand, diversify and manage business enterprises, as well as link them with financial institutions for start-up capital, especially the microfinance banks.
- generate employment opportunities for Nigerians
- raise a new class of entrepreneurs/business owners, who can compete globally, and provide the bridge for future industrialization of the country.

The state governments were encouraged to:

- set aside 1.0 per cent of their annual budgets for on-lending through MFBs to their residents
- mobilise local government areas (LGAs) to set aside 1.0 per cent of their budgets for on-lending purposes
- mobilise high net worth indigenes to float MFBs.
- sensitise citizens on microfinance in collaboration with the CBN

As at end of 2010, the centres had trained and counselled 49,697 graduates, created 1,825 jobs and 595 trainees were given assistance to access loans for their businesses.

III.2 Baseline Economic Survey of Small and Medium Industries in Nigeria

The CBN undertook a detailed study of the SMI in Nigeria in 2003/2004, as a means of providing widely disseminated and comprehensive information on SMI in Nigeria. The Report on the study was launched on 13th September, 2005. It has four sub-reports on regional basis as follows:

(a) **Survey of Existing SMIs:** This contains, among others, characteristics of SMI, employment profile, production inputs, production technology, infrastructure and capital investment, production capacity and cost structure, growth potentials and marketing, government policy and recommendations, on local and state government basis.

(b) **Potential Investment Projects Profiles:** This contains potential SMI project profiles in different parts of the country. On the whole, 740 potential investment profiles were prepared with information on zonal advantages, raw materials, products, machinery and equipment and preliminary investment costing.

(c) **Project Inventorising:** This provides information on the quality and quantity of raw materials, products, their possible uses, as well as infrastructural facilities available in each zone, state and community.

(d) **Research and Development Activities:** This is a profile of research activities on SMIs carried out by different research institutions across the country.

IV. A Review of Current Initiatives for Real Sector Development

In line with the objective of making financial sector developments to impact positively on the real sector of the economy, as enunciated in the current banking sector reforms, the CBN embarked on new initiatives, aimed at enhancing the flow of finance to some priority sectors. These include:

IV.1 ₦200 Billion Commercial Agricultural Credit Scheme (CACS)

The CACS was established in 2009 by the CBN, in collaboration with the Federal Ministry of Agriculture and Water Resources (FMA&WR). It is being funded through the issuance of FGN Bond worth ₦200 billion, by the Debt Management Office (DMO) in two tranches. The first tranche of ₦100 billion has been raised and passed on to participating banks for on-lending to farmers. Loans made under this scheme are at single digit interest rate subject to a maximum of 9.0 per cent while the CBN bears the interest subsidy at maturity. The scheme was initially to promote commercial agricultural enterprises but was later revised to accommodate small scale farmers through the on-lending scheme of the state governments. All the 24 banks in the country are expected to participate in the administration of the scheme. As at end-December 2010, a total of ₦96.81 billion had been disbursed to eleven banks, including disbursements to 15 state governments, for financing 104 projects.

IV.2 ₦500 Billion Development Bond

As part of the effort by the CBN to show the way towards enhanced financing of the real sector and infrastructure projects, and improve credit flow to the sector, a ₦500.0 billion Fund was established out of which ₦300 billion is earmarked for Power/Infrastructure and Aviation projects, and ₦200.0 billion for the Refinancing/Restructuring of banks' existing loan portfolios to manufacturers/Small and Medium Enterprises (SMEs).

IV.2.1 ₦300 Billion Power and Aviation Intervention Fund

From the ₦500 billion Development Bond, the CBN allocated the sum of ₦300 billion to stimulate credit to the domestic power sector and the troubled airline industry. The main objective of the initiative was to help finance badly needed power projects and to allow banks to refinance loans to the heavily-indebted airline industry. It was intended to refinance existing loans and leases and provide working capital for the two sectors. The programme would operate in such a way that banks will be able to access the fund at an interest rate of 7.0 per cent (BOI 1.0 per cent as management fee and participating banks, 6.0 per cent), including all charges, payable on a quarterly basis, The Fund is managed by the Bank of Industry (BOI) while the Africa Finance Corporation (AFC) is the technical adviser. All the 24 commercial banks and development finance institutions (excluding BOI) have all been enlisted to participate in the scheme. The framework for the take-off of the scheme was in place by the end of 2010.

IV.2.2 ₦200 Billion Restructuring/Refinancing to the Manufacturing Sector/SME

Also from the bond, the CBN made available ₦200 billion for the re-financing/re-structuring of banks' existing loan portfolios to the manufacturing sector and SMEs. The main objective of the Fund is to fast-track the development of the manufacturing sector by improving access to credit by manufacturers as well as improving the financial position of the DMBs. The types of facilities under the Fund include long-term loans for acquisition of plant and machinery, refinancing of existing loans, resuscitation of ailing industries, working capital and refinancing of existing lease. The loan amount for a single obligor is a maximum of ₦1 billion in respect of re-financing/re-structuring with an interest rate of 7.0 per cent payable on quarterly basis. As at end December 2010, the sum of ₦199.67 billion had been disbursed to BOI, out of which the participating banks received ₦197.59 billion.

IV.3 Small and Medium Scale Enterprises Credit Guarantee Scheme (SMECGS)

The SMECGS was established by the CBN in 2010 with an initial capital of ₦200 billion to promote access to credit by SMEs in Nigeria. The scheme provides guarantees on loans by banks to the sector to absorb the risk element that inhibit banks from lending to the real sector. The activities covered under the scheme include manufacturing and agricultural value chain; SMEs with assets not exceeding ₦30 million and labour force of 11 to 300 staff; and processing, packaging and distribution of primary products.

The main objectives of the Scheme are to: fast-track the development of SME/Manufacturing sector of the economy by providing guarantees; set the pace for industrialisation; and increase access to credit by promoters of SMEs and manufacturers. The maximum amount to be guaranteed under the scheme is ₦100 million, which can be in the form of working capital, term loans for refurbishment, equipment upgrade, expansion and overdraft. The guarantee covers 80 per cent of the borrowed amount and is valid up to the maturity date of the loans, with maximum tenure of 5 years. All the deposit money banks are eligible to participate in the scheme and the lending rate under the scheme should be the prime lending rate of the banks since the CBN is sharing the credit risk with the banks by providing guarantee. At end-December 2010, two applications valued at ₦107.5 million had been processed.

IV.4 Nigerian Incentive-based Risk Sharing for Agricultural Lending

In spite of the plethora of financing schemes, the issue of adequate, affordable and timely access to credit by Nigerian farmers remains a major challenge. For example, between 2006 and 2010, the agricultural sector attracted on average just 2.0 per cent of the total credit to the economy in contrast to its average contribution of 41.7 per cent to the GDP over the same period (CBN, 2010). The low credit to the sector by the banking industry could be attributed to a number of reasons, notable among which are the high risk inherent in the sector and the perception that it is non-strategic to their business models. Hence, as long as these concerns linger, the issue of financing agriculture in Nigeria would require more than just providing funds to the sector. It is against this background that a new financing framework, the Nigerian Incentive-based Risk sharing System for Agricultural Lending (NIRSAL) is being introduced.

This model of financing agriculture is different in many ways from the current financing models which have not yielded the desired impact of making adequate credit available to the sector. NIRSAL is a demand driven credit facility rather than the current supply driven funding. It adopts a value chain approach to lending as banks would be free to choose which part of the value chain they would be interested in lending to. It would build the capacity of the banks to engage and deliver loan; reduce counterpart risks facing banks through innovative crop insurance products; reward performance in agricultural lending; and would be managed with performance- based incentives. The objectives of the programme include to:

- Stimulate innovations in agricultural lending;
- Encourage banks to lend to the real sector;
- Eliminate state dependency by banks for deploying loanable funds to agriculture;
- Leverage DMBs balance sheet for lending into agriculture; and
- Ensure risk sharing approach that will build a business model in which banks share in the risk of lending to the sector.

V. The Nigerian Economy: Development Perspective

Nigeria is the single largest territorial unit in West Africa, with a land area of 923,768 square kilometers and a population of about 159 million people (CBN, 2010). The annual population growth rate is 3.2 per cent, with a gender population ratio of 51.2 per cent male and 48.8 per cent female. Approximately 60 per cent of the labour force earns livelihood from farming. Nigeria has vast natural resources with oil reserves of about 37 billion barrels estimated to last over the next 30 years, while gas reserves of about 176 trillion cubic meters could be depleted in approximately 72 years. In the early 1970s, Nigeria's per capita GDP was estimated at US$1,000, which was well above the world poverty line. But times changed. The promise of greatness has been betrayed as Nigeria used her enormous wealth from oil export for massive importation of goods and services, to the utter neglect of domestic production. This state of affairs could not be sustained owing to the vagaries of oil production and prices in the international oil market. As the oil boom burst from the mid-1980s, the Nigerian economy headed downward in spite of the effort made by the CBN through monetary policy measures and developmental functions.

Analysis of the performance of the economy revealed a deteriorating state (Table 2).

Table 2: Average GDP Growth (Per cent)

Period	Growth Rate
1960-1970	5.9
1971-1973	8.0
1976-1980	3.2
1982-1990	3.2
1991-1998	1.9
1999-2007	8.3
2008-2010	7.1

Source: National Bureau of Statistics

From an annual average growth rate of 8.0 per cent in the period 1971-73, the growth of the GDP nose-dived to 3.2 per cent during 1976-80 and 1982-90, just the same as the population growth, implying that there was no real growth. Yet the 1990s was the worst period for Nigeria, as the growth plummeted further to 1.9 per cent. However, during the period 1999-2007, output growth rebounded to 8.3 per cent, reflecting the effects of massive macroeconomic reforms and policies embarked upon by the democratic dispensation from 1999. Thus, the economy recorded improved performance during the 2000 decade.

Table 3: Nigeria's Major Macro-Economic Indicators (1991 - 2010)

Indicator	Average 1991 – 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average 2001 – 2010
GDP Growth Rate (%)	2.3	4.7	4.6	9.6	6.6	6.5	6	6.5	6	7	7.9	6.5
Inflation Rate (%)	31.3	16.5	12.1	23.8	10	11.6	8.5	6.6	15.1	13.9	11.8	13
M2 Growth Rate (%)	32.6	27	21.6	24.1	14	24.4	43.1	44.2	57.8	17.5	6.7	28
Current Account Balance (as % of GDP)	-	4.7	1.5	7	17.6	32.8	23.5	16.8	13.7	7.9	1.5	12.7
External Reserves (US $ Billion)	4.3	10.3	7.7	7.5	17	28.3	42.3	51.3	53	42.4	32.3	29.2
Exchange Rate End-Period (N/US$)	48.5	112.5	126.4	135.4	132.7	130.3	128.3	117.9	132.6	149.6	150.7	131.6
External Debt (US $ Billion)	29.2	28.3	31	32.9	35.9	20.5	3.5	3.7	3.7	3.9	4.6	16.8
Maximum Lending Rate (% per annum)	24.4	21.3	30.2	22.9	20.8	19.5	18.7	18.2	21.2	23.8	21.9	21.8
Credit to Private Sector	-	43.5	19.7	18.4	26.6	30.8	32.1	90.8	59.4	26.6	22.5	37.1

Source: CBN Annual Reports (various issues)

The economy grew modestly from 4.7 per cent in 2001 to 7.9 per cent in 2010, with a peak of 9.6 per cent in 2003. The decade average growth was 6.5 per cent, compared with 2.3 per cent of the previous decade. The sectoral growth drivers during the decade were agriculture, crude oil and gas, building and construction, commerce, communications, and real estate development.

Other macroeconomic indicators improved significantly. Inflationary pressures moderated, recording single digit in 2006 and 2007, averaged 13.0 per cent, compared with 31.3 per cent in previous decade. The external reserves rose steadily, from US$10.3billion in 2001 and peaked at US$53.0 billion in 2008. Nigeria's external debt moved in the reverse order, from US$28.1 billion in 2001 to just US$3.5 billion in 2006 and remained low since then.

In spite of these improvements, many development indicators headed downwards, indicating that the growth was externally driven and not inclusive.

Table 4: National Unemployment Rates

Year	Rate (Per cent)
2000	13.1
2001	13.6
2002	12.6
2003	14.8
2004	13.4

2005	11.9
2006	12.3
2007	12.7
2008	14.9
2009	19.7

Source: National Bureau of Statistics, Labour Force Survey, March 2009

The unemployment situation has been worrisome, as it deteriorated from 13.1 per cent in 2000 to 19.7 per cent in 2009. An intriguing paradox is that there is high and rising unemployment rate despite the exciting recent GDP growth rates. For example in 2008 and 2009 when the GDP growth rates were 6.0 and 7.0 per cent, unemployment rate was 14.9 and 19.7 per cent, respectively. This ugly situation has revealed that Nigeria's growth has not generated commensurate employment opportunities.

Using the United Nations Development Programme (UNDP) Human Development Index-a comparative measure of life expectancy, literacy, education, and standards of living- Nigeria is in the list of Low Human Development countries. In 2010, it took the 145th position out of the 172 countries evaluated, with a score of just 0.423, in deed below many countries in Africa. This information tends to support the NBS report which shows that about 54.0 per cent of the total Nigerian population live below the poverty line, out of which 63.3 per cent are in the rural areas.

V.2 Vision 2020

The Vision was aimed at restructuring the economy for industrial development, increasing national and per capita incomes, improving the living standards of the people and ultimately reducing poverty in the country. The target of raising the level of the GDP from US$191.4 billion to US$900 billion in 2020, almost a five-fold increase, and becoming one of twenty largest economies in the world, requires that all the sectors be made to work efficiently and effectively.

Building on the gains from the National Economic Empowerment and Developmental Strategy (NEEDS), the key features of Vision 2020 are:

- Polity – The country will be peaceful, harmonious and stable.
- Macro-Economy – A sound, stable and global competitive economy with a GDP of not less than US$900 billion and a per capita income of not less than $4000 per annum.
- Infrastructure – Adequate infrastructure services that support the full mobilisation of all economic sectors.
- Education – Modern and vibrant education which provides for every Nigerian the opportunity and facility to achieve his maximum potentials and provides the economy with adequate and competent manpower.
- Health – A health sector that supports and sustains a life expectancy of not less than 70 years and reduces to the barest minimum the burden of communicable diseases such as tuberculosis, cholera, HIV/AIDS and other debilitating diseases.
- Agriculture – A modern technologically agricultural sector that fully exploits the vast resources of the country, ensure national food security and contribute significantly to foreign exchange earnings.
- Manufacturing – A vibrant and globally competitive manufacturing sector that contributes significantly to GDP with a manufacturing added value of not less than 40 per cent.

Thus, the Vision 2020 sets out the framework and agenda for the development of Nigeria, and putting her in the league of the twenty largest economies in the world. But seven years after the adoption of the Vision and eleven years to the target date, the country seems not to be moving along this path of development. It has not made any significant importance in any of the parameters. At end-2010, Nigeria's economy was estimated at US$193.7 billion and ranked as the 44th largest economy by the World Bank, far behind Poland, Switzerland and Indonesia that took the 20th, 19th and 18th positions, respectively. Growing at the current rate of 6.5 per cent per annum, Nigeria would produce a GDP of US$380.2 billion by 2020, which is below the GDP of Poland, Switzerland and Indonesia in 2010. Indeed, Nigeria needs to grow by 14 per cent per annum to overtake Poland in 2020, Switzerland 13 per cent and Indonesia 20 per cent (World Bank).

Table 5: Comparative Analysis of the Nigeria's GDP with Some Selected Countries

Countries	Nigeria (44th)	Poland (20th)	Switzerland (19th)	Indonesia (18th)
2010 GDP (millions of US$)*	193,669	468,585	523,772	706,558
Current GDP Growth Rate (10yrs Average, Percent)*	6.5	3.90	1.63	5.17
2020 GDP Projection (Using Current Growth Rate, millions of US$)	380,263	686,980	615,689	1,169,679
Growth Rate (Percent) needed to match Poland, Switerzerland and Indonesia	-	13.50	12.26	19.70

Source: *The World Bank

VI. Summary and Conclusion

The paper x-rayed the role of the Central Bank of Nigeria as an agent of economic development. The central bank impacts the economy via: ensuring monetary and price stability; management of external reserves; issue of legal tender currency; financial system management; the payments system; and developmental roles. Its developmental role has been given special attention in recent years with its intervention in the real sector.

Monetary and price stability is a necessary but not sufficient condition for attaining higher growth rate and development. Other necessary conditions for the attainment of Vision 2020 include, but not limited to, harmonious and consistent research-based policy formulation and implementation; political will that can see initiatives through and ensure continuity through the setting up of strong institutions backed up by law; and massive investment in the energy sector, particularly electricity generation and distribution, as well as in petroleum refinery development. Other sectors that call for urgent attention are extensive road rehabilitation and construction of new ones, development of the rail system, expansion and modernisation of the airports and the seaports, improvement in the quality of education and health in order to ensure the provision of healthy manpower.

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Financing Inclusive Growth in Nigeria: Challenges and Prospects

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… More diversified economies are also likely to deliver more inclusive growth – growth that create jobs for more people, and shares the benefits more widely. We know from recent experience how much the social dimension matters for long-run stability… Of course, countries that are commodity exporters have in recent years benefitted from higher prices. For them, the challenge is to use the gains from higher prices wisely – to preserve macroeconomic stability, but also to share the natural resource wealth fairly across society, and across generations.

(Lagarde, 2011)

The biggest challenge here is the KYC (know your client) issues and how to ensure that the borrower does not disappear. Ultimately, there is no substitute for credit information bureau/registry system which is comprehensive, ubiquitous and effective … mobile banking and cashless payments will go a long way in promoting financial inclusion.

(Krishnan, 2011)

I. Introduction

Nigeria's growth and development paths in the last five decades have been based on various economic models and development plans. From independence in 1960 to 1985, the Keynesian macroeconomic doctrine, which emphasizes the need for government involvement in the economy, ruled as the economic policy of the governments while thereafter and since the adoption of the World Bank/IMF sponsored Structural Adjustment Programme (SAP) in 1986, the country has vacillated between Neo-Classical and Keynesian doctrines.

Immediately after the civil war in 1970, Nigeria adopted Import Substitution Industrial (ISI) growth model with the hope of industrialising while reducing imports of food and industrial inputs over time. The subsequent improvement in oil output and quadrupling of the oil prices in 1974 with attendant huge revenue from the source resulted in the abandonment of the ISI growth path. Thereafter the

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government took over the "commanding height" of the economy by getting involved directly in production of goods (industrial and agricultural ventures) and services (banking, insurance, shipping, etc) either through nationalisation of businesses or investing in new enterprises.

This route to economic development, which was rooted in the Development Plans that was the vogue at that time, was truncated by oil gloom and world economic crisis of 1981 to 1984. Eventually in 1986, Nigeria adopted the SAP and the government de-emphasised its leadership role giving way to private-led economic growth path and deregulation of prices and markets. The SAP was a short-term economic therapy (supposedly two-year programme) to restructure the economy from heavily regulated to a deregulated state. It was accompanied with a medium-term Rolling Plan as substitute for the Five Year Development Plans. The SAP ended up deregulating the markets and prices without bringing about the required restructuring capable of providing impetus for real growth. Domestic value of the naira was depreciated through market forces, so also was the rising nominal interest rates in the money market leading to high cost of production and lowering living standards. Free market or deregulated economy was in 1994-1996 jettisoned for "guided deregulation". Thereafter, mixture of economic policies without theoretical foundation was adopted from time to time up to the present time of Vision 20:2020 which include tangentially, inclusive growth.

Was there any special role for the financial system, particularly money and capital markets, in the implementation of these foregoing economic policies? Any role for the foreign exchange market? Answers to these questions will be provided in a later section, albeit, the objective of this paper is to suggest an explicit link between inclusive growth path and the financial sector.

The rest of this paper is divided into four Sections. The next section, Section 2, contains literature on theoretical construct on economic growth and development models, including Inclusive Growth (IG) model while in Section 3 we present the role of money in economic growth. Section 4 looks at models of financial inclusion and evidence of financing inclusive growth in some developing countries. In Section 5, we identified challenges and prospects for financing inclusive growth in Nigeria. Section 5 is the concluding remark where some recommendations are proposed for successful inclusive growth financing in Nigeria.

II. Theoretical Literature

Literature is replete with not only the theories of growth and development but also their failure to lift the developing countries out of the poverty quagmire. A number of emerging countries link their development plans to specific theories in order to give focus to the factors/variables that can be manipulated to achieve the desired goals, as well as, provide avenue for measurements or deviation from/alignment with targets set by those theories. For instance, India does this regularly (Raj, 1961, Jinghan, 2006), so also is Malaysia, China and other emerging economies. Nigerian plans are hardly based explicitly on a model which leaves room for conjecture.

In fact, continuous research into and proposal on how economies can grow and develop are attempts to assist the less developed countries (LDCs) to catch up with developed countries (DCs). As these theories emerge, some LDCs also emerge from the poverty tangle, either as a result of the application of the new theories or completely through application of some home-grown thesis. The import of this section is to provide an overview of some of the theories, including the Inclusive Growth model.

The Harrod-Domar (H-D) growth models often form the starting point for discussing growth theories. The H-D models (1947; 1957) were developed separately by Harrod and Domar but they converged at the same point of placing emphasis on the role of saving and investment in the process of economic growth. If saving is growing and channelled to productive investments, income will grow with concomitant growth in capital and output. Being a classical model, full employment equilibrium in the economy is important. Thus, to maintain full employment equilibrium level of income continuously from year to year, both output and real income must expand at the same rate with the productive capacity of capital stock expansion. The equilibrium rate of growth is also called the “warranted rate of growth”.

A number of other growth theories have since emerged. These include Kaldor Model of Growth (1957) which provide framework for relating the genesis of technical progress to capital accumulation; Pasinetti Model of Profit and Growth (1962), Mahalanobis Model (1953) of two-sector and later four-sector model which formed the basis for India's 2nd National Development Plan; The Solow Neoclassical Growth Theory (1956), and, the New Endogeneous Growth Theory. The theories of relevance for discussion in the paper are the Solow and the New Growth theories.

The Solow neoclassical long-run growth model, based on a number of assumptions including variable technical progress, constant return to scale and full employment of labour and available capital stock, hypothesised that there would be tendency for capital-labour ratio to adjust towards equilibrium ratio over time. If, initially, the ratio of capital to labour is more, capital and output would grow more slowly than labour force, vice versa. A more important element of the theory is the assumption of exogeneity of technology which he predicted that could make developing countries (LCDs) to be faster than the developed countries (DCs) and the per capital income in these countries (LDCs) would converge to the level of the DCs over time while the GDP growth rate in a country will eventually be the same as the growth rate of the population.

In conjunction with Swan, and in what is known as Solow-Swan neoclassical growth theory, they posited that the long-run growth rate of output are based on two exogenous variables viz the rate of population growth and the rate of technological progress. Here, growth is independent of the saving rate and government policy actions.

The Endogenous growth models (EGMs) can be regarded as a reaction to the Solow-Swan growth model. The prediction by the neoclassical growth theory that the LDCs will grow faster than the DCs and per capita income in the former will converge to the level of the DCs did not materialise for those LDCs that actually witnessed economic growth. The EGMs were developed by economists like Romer (1986, 1990) and Lucas (1988) though Arrow (1962) had earlier in 1962 provided a glimpse into future about role of knowledge-based economy in economic growth equations. The models emphasise existence of technical progress arising from rate of investment, the size of capital stock and the stock of human capital.

The EGMs are based on some general assumptions viz:

- There are many firms in the market
- Knowledge or technological advance is a non-rival good
- There are increasing returns to scale to all factors taken together and constant returns to a single factor, at least for one factor;
- Technological advancement comes from things people do or creation of new idea; and
- Many individuals and firms have market power and earn profits from their discoveries. This assumption emanates from increasing returns to scale in production under situation of imperfect competition (Jhingan, 2006:292xxv)

i. Arrow (1962) regarded labour as endogenous and, therefore, introduced the concept of *'learning by doing'* in the growth process. He averred that new capital goods incorporate all the available knowledge based on accumulated experience though once built, their productive deficiencies cannot be changed by subsequent learning. Thus, he did not explain that his model could lead to sustained endogenous growth. The theory was later extended and generalised by Levhari and Sheshinski who argued that spill-over effects of increased knowledge by labour through *learning by doing* is actually the source of knowledge or each firm's investment.

Also, King and Robson developed a model extending Arrow's thesis but emphasising *Learning by watching* in their technical progress function. They contended that investment by a firm represents innovation to their own needs and innovation in one sector of the economy has contagion or demonstration effects on the productivity of other sectors, thereby leading to economic growth. They opined that even for economies that have similar initial endowments, multiple steady state growth paths exist and policies that increase investment should be pursued.

ii. Romar Model: Romer first presented a variant of Arrow's paper in 1986 and this is known as *Learning by Investment*. He assumed that creation of knowledge is a by-product of investment and takes knowledge as an input in the production function. It is spill-overs from research efforts by a firm that leads to the creation of new knowledge by other firms. New knowledge is the ultimate determinant of long-run growth and is, thus, determined by investments in research technology. He, however, explained that research technology exhibits diminishing returns such that investments in such research will not double knowledge. Also, there is always spill over benefits of any increase in knowledge from one firm's research output. The other firms also benefit from the research output freely due to absence of patent protection. Romer affirms that investment in research would lead to increased output thereby making knowledge an endogenous factor such that rational profit maximising firms should engage in acquisition of new knowledge through research.

In 1990, Romer moved a step further with his *model of Endogenous Technical Change***.** The model recognises research sector as specialising in the production of ideas. Romer considers ideas as being more important than natural resources and cited the case of Japan which has no mineral resources but highly skilled human capital and dominated the electronic world for a long time. He concurred that ideas are essential for the growth of an economy as this would bring about improved designs for the production of producer durables good for final production.

iii. The Lucas Model: Lucas (1988) assumes that investments in education results in production of human capital. The crucial determinant in the growth process, according to Lucas, is the stock of human capital which effects he divided into two. Internal effects of human capital relates to where the individual benefits from training by increasing his productivity while the external effect increases productivity of capital and other workers in the economy. He posited that it is the investment in human capital that results in improvement in the level of technology. There is constant return to scale for each firm but increasing returns to scale for the economy as a whole. Lucas opined that it is not the accumulated knowledge or experience of other firms but the average level of skills and knowledge in the economy that are crucial for economic growth. Technology is therefore treated as a public good from the point of view of its users and endogenously provided as side effects of investment decision by firms.

The new growth theories above, though a departure from the earlier models, could not provide satisfactory explanation for the rapid growth and convergence of the newly industrialised economies of the Asian Tigers and the

BRIC States[1] (Pack, 1994; Grossman and Helpman, 1994; Lin, 2004). The investments in research and development, human capital and learning by doing in these countries were much lower than in the DCs, yet they grew at unexpectedly high rate.

For those developing countries that have been unable to catch up, a series of reasons has been adduced for it. The reasons include government interventions and regulations, wide spread corruption or helping (grabbing) hand of government, weak protection for investors, weak institutions, poor infrastructural facilities and lack of security (Shleifeer *et al.*, 1998; Rodrick, 1998, 2003; Acemoglu *et al.*, 2002a; Djankov *et al.*, 2003). The World Bank (2005) in its Report entitled *Economic Growth in the 1990s: Learning from a Decade of Reform* concludes that although the necessary fundamentals for growth such as a stable macroeconomic environment, enforcement of property rights, openness to trade, and effective government are key factors in the growth process, they are not the whole story.

While some economists continue to look into the causes of continuous underdevelopment of the LDCs in Africa and elsewhere (Shleifer and Vishny, 1993, 1988; Djankov, La Porta, Lopez-de-Silanes, and Shleifer, 2002; La Porta *et.al.*, 1998, 1999; Engerman and Sokoloff, 1997; La Porta *et al.*, 2001a) , the results on study of the Newly Industrialised Economies (NIEs) in Asia and the BRICS States have shown that their economic growth path did not follow the neoclassical and endogenous growth theories in their strict doctrine. The growth rates have some additional underlying impetus that propelled it without reaching the expected level of R & D and human capital development. This is the import of inclusive growth, which is fully discussed in below.

iv. The Inclusive Growth Model: There seem to be no formal theory setting up the Inclusive Growth path to development but the nature of the model can be gleaned from the lecture delivered by Justin Yifu Lin at the Asian Development Bank's Distinguished Speakers Program in 2004. In the lecture entitled "Development Strategies for Inclusive Growth in Developing Asia", Lin explained that most developing countries which are characterised by abundance of labour

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[1] Asian Tigers are Korea (south), Malaysia, Singapore, Honk Kong, Taipei while BRIC States are Brazil, Russia, India and Peoples Republic of China (South Africa joined recently to form BRICS).

and scarcity of capital adopted capital intensive industries. This he referred to as Comparative Advantage - Defying (CAD) Strategy because the government attempts to encourage firms to ignore the existing comparative advantage of the economy in their choice of industry and technology, with resultant unemployment of the available huge labour.

Lin advocated 'Comparative Advantage-Following (CAF) strategy whereby government encourage firms in the country to enter industries for which the country has comparative advantage and to adopt the technology in production that will make the firms viable. This strategy, he argued, will make the countries benefit from the "advantage of backwardness" as suggested by Simon Kuznets (1966). He posits that CAF will cause the economy to:

> have a larger surplus, accumulate more capital, and have a faster upgrading of endowment structure than what are possible under the CAD strategy. The economy will also have a better income distribution as well because the CAF strategy will create more job opportunities for the poor…

Even when the question has been 'What is Inclusive Growth?' there have been attempts at explaining the meaning rather than defining the concept. Chakrabarty, the Deputy Governor of the Reserve Bank of India explains that:

> Growth is inclusive when it creates economic opportunities along with ensuring equal access to them. Apart from addressing the issue of inequality, the inclusive growth may also make the poverty reduction efforts more effective by explicitly creating productive economic opportunities for the poor and vulnerable sections of the society.

The term inclusive growth' was said to have been popularised by the India Development Policy Review of 2006. The Review which was titled "Inclusive Growth and Service Delivery: Building on India's Success", focused on two major challenges facing India namely (i) improving the delivery of core public services and (ii) maintaining rapid growth while spreading the benefits of the growth more widely.

The Indian Planning Commission (2007) also explained that the concept "Inclusion" should be seen as a process of including the excluded as agents whose participation is essential in the very design of the development process, and not simply as welfare targets of development programme.

Lanchovichina and Lundstrom (2009) argued that the definition of inclusive growth implies a direct link between the macro and micro determinants of growth and captures the importance of structural transformation for economic diversification and competition. The model is about the pace of growth and enlarging the size of the economy, while levelling the playing field for investment and increasing productive employment opportunities.

Furthermore, the main instrument for a sustainable and inclusive growth is assumed to be productive employment. They distinguished between *employment growth* and *productivity growth*. The former generates new jobs and income for the individual – from wages in all types of firms, or from self-employment, usually in micro firms while productivity growth has the potential to lift the wages of those employed and the returns to the self-employed.

Ianchovichina and Lundstrom (2009) explained that rapid and sustained poverty reduction requires inclusive growth that allows people to contribute to and benefit from economic growth. Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable over time, it should be broad-based across sectors, and inclusive of the large part of the country's labour force. Inclusive growth is about raising the pace of growth and enlarging the size of the economy, while levelling the playing field for investment and increasing productive employment opportunities. Inclusive growth approach takes a longer term perspective as the focus is on productive employment rather than direct income distribution as a means of increasing incomes for excluded groups (Ianchovichina and Lundstrom, 2009).

The Commission on Growth and Development of the World Bank (2008) notes that 'inclusiveness' is an essential ingredient for any successful growth strategy and is a concept that encompasses equity, equality of opportunity, and protection in market and employment transitions. However, there is limited analytic study integrating the literature on growth and productive employment.

We can look at the Inclusive Growth model as an extension of the Endogenous Growth model in a sense that both recognise the importance of technological advancement and human capital development as ingredient of economic growth but the former is equally concerned about creation of more job opportunities to reduce unemployment, improve and spread income to the poor and vulnerable in a sustainable manner.

In concluding this section, it is important to ask the question: What is the role of money and finance in all these economic growth models? This is considered in the next section.

III. Economic Growth: What is the Role for Money and Finance?

The role of money in the classical view has to do with price movements alone. In this connection, money does not influence real sector activities where growth variables interact. Thus, while the classical and neo-classical models discussed above recognise the role of saving in providing the required loanable fund for investment and growth, they do not see saving as money supply or deliberate attempt of government or the private sector to raise finance but as outcome of thriftiness of the society. In that context, therefore, we cannot place economic growth, in the neoclassical thesis, at the doorstep of deliberate financial policy. However, firms do use retained earnings for further investments in addition to saving and economic growth results therefrom.

There is implicit proposition for financial needs to engineer growth in the endogenous growth theories. This should not be surprising as the theories place emphasis on growth rate of investment, the size of the capital stock and the stock of human capital and technology which require higher financial commitments. Of course, those theories arose at the time economists have come to realize the importance of finance in economic growth. The endogenous variables have much to do with the private sector and as well as with government which would need to use its fiscal might to finance investment or rely on its financial institution to do same. However, who is responsible for investing in the human capital and technology? the government or the private sector? the theories neither explain nor include it in the assumptions on which they are based. This is not the case with the inclusive growth model.

The inclusive growth model explicitly brings the role of government and role of finance into focus and this is captured in a number of write ups that have dotted the policy landscape since the popularisation of the model. Suffice to bring home the thoughts on this with the concluding remark by the Deputy Governor of the Reserve Bank of India, K.C. Chakrabarty (2011) when he stated:

> I would like to reiterate that the current policy objective of inclusive growth with stability is not possible without achieving universal Financial Inclusion. Thus financial inclusion is no longer a policy choice today but a policy compulsion. And as agents entrusted with the task of achieving financial inclusion, the role of the mainstream financial sector in achieving inclusive growth becomes central.

In discussing the challenges and prospects of financing inclusive growth in Nigeria as we present in the next section, it is imperative to look at the models of inclusive growth in some developing countries and the experiences in financing inclusive growth in Asia where the growth model has become synonymous. It is important to recall that financing inclusive growth means extending financial services and supports to the excluded or vulnerable segment of the society – the poor. This is not in form of income re-distribution but financing productive investments and promoting entrepreneurship. Let us start by looking at some models of financial inclusion.

IV. Models of Financial Inclusion[2]

The following are some model of financial inclusion that are practically initiatives of the private sector of the respective economies:

i. Republic of South Africa**:** The model is called "*No Frills Banking*" which is the launching of Mzansi accounts in 2004 with negligible minimum deposit and a set of number of free transactions. Within five years, six million accounts were opened, particularly by the informal economy. However, only 55% of the accounts was reported to be active at the end of 2010.

ii. Brazil: Here, the model is '*Branchless Banking*'. It has been in existence since 1970s and by 1997, about 40 million out of 62 million Brazilians did not

[2] This section benefits greatly from Misra (2010) and prepared reports by various bodies.

have access to any financial services. Thereafter, innovative policies were put in place to revitalise activities of the institutions and the total bank accounts in the country doubled between 2000 and 2008, from 63.7 million to 125.7 million.

iii. Kenya**:** Referred to as "*Bank without a Bank*". The model is such that there is no need to have a bank account but use a mobile phone company as mechanism for money transactions. Two mobile phone connections are attached to every bank account. The Kenyan authorities allow a mobile phone company to act as the repository of customers' money and allows them to transact businesses, though with no interest on saving and the company too cannot use the money for businesses. Safaricom-Vodafone launched M-PESA in 2007 as a parallel bank happening in real time through a wide network of about 17,000 'agents' and with about 10 million Kenyans now involved.

iv. Mexico: Entitled "*Super-Efficient Lending Mission*" by the non-profit organisation that started it (Branco Compatamos). The model is to show that microfinance is a business of scale and private capital. It is a profit-led model and has been found successful even with its 100 percent plus interest rate which might be the same or lower than what money lenders charge. It is regarded as a very efficient system with lots of innovation and cost minimisation and with growing profits.

These models need in-depth study to understand the workings of the systems. Presented below is a quick review of financial development and inclusive growth with formal government (or its agency) participation as adopted in some developing countries.

i. Financing Inclusive Growth in Bangladesh[3]: The government's programmes and policies seek to accelerate inclusive economic growth by focusing public expenditure outlays in developing the social and physical infrastructure, crowding in private investments in output activities. The Bangladesh Central Bank supports the government efforts on inclusive growth through its

[3] The information provided here is based on the Global Policy Forum 2011 held in Mexico.

financial inclusion drive which involves engaging banks in reaching out with credit and other financial services to productive pursuits in under-served areas like rural farming, small and medium scale enterprises, renewable energy and other environmentally benign ventures. To be able to reach large proportion of the new clients, the branch banking financial services are complemented with mobile phone/smart card based remote delivery and also by on-lending/co-financing partnerships of banks with locally active regulated Micro Finance Institutions (MFIs).

The financial inclusion drive in Bangladesh has successfully engaged commercial banks with different ownership (state-owned, private and foreign) in financing agriculture such that more than nine million new bank accounts for rural farmers were said to be opened in 2011 alone and around a third of the 2011 agricultural financing of private banks took place through bank-MFIs partnership with resultant increase in rural wages and reduction in poverty.

The Governor of the Bangladesh Bank reported that the Bank embarked on the process of ingraining the vision of financial inclusion in the financial sector by first issuing guidance for mainstreaming of Corporate Social Responsibility (CSB) obligations in institutional goals and strategies of all banks and financial institutions. These make the banks to be proactive in innovating efficient, cost effective mode of reaching out to the excluded and underserved population segments.

ii. Financial Inclusion in Malaysia[4]: The Malaysian financial inclusion programme was developed in concert with the development of the overall financial sector which has strengthened significantly in the recent decade in terms of stability, outreach and delivery. According to the World Bank Report (WBR) on inclusive growth in Malaysia, there are four broad strategies adopted to promote financial inclusion in Malaysia. These are:

- Strengthening development financial institutions (DFIs);
- Leveraging on the commercial banks' distribution network, product and risk management capabilities;

[4] Obtained from the World Bank: Malaysia Economic Monitor – Inclusive Growth, November, 2010. Pp.87-88.

- Building a comprehensive supporting infrastructure for the effective management of risks by financial institutions to reach out to the underserved; and
- Putting in place a comprehensive consumer protection, redress and education framework, hence promoting greater confidence and knowledge among consumers to utilise financial services.

The DFIs in Malaysia are government established specialised financial institutions with specific mandates to further the strategic national development agenda such as infrastructural development, fostering trade linkages and advancing financial inclusion. These institutions include the National Saving Bank (NSB), the Agricultural Bank (AB) and SME Bank. The NSB was given strengthened mandate to mobilise savings in underserved areas, promote micro-financing and rationalise the postal banking system while AB had been transformed to deepen access to financing the agriculture sector and the SME Bank was established to focus on serving the SME sector.

The World Bank Report (2010) explains that pursuit of financial inclusion in Malaysia adopts a collaborative approach that involves the government and the private sector. This approach effectively combines the innovation and enterprise of the private sector with the pivotal role assumed by the public sector. Both the Government and the Central Bank combine to create an enabling environment for the drive to raise the levels of financial inclusion, to strengthen the institutional structures, promoting long-term safety and soundness, facilitating a cohesive strategy through effective interagency coordination and catalysing commitment to the financial inclusion agenda.

The results of the financial inclusion strategy, as reported in the WBR (2010), indicate that more than 80 per cent of Malaysia's adult population have deposit accounts, which is one of the best globally. The bank branches nationwide has grown from 298 in 1990 to 2, 981 at the end of 2009 and the automated teller machines (ATMs) which was 1,193 in 1990 increased to 8,982 at the end of 2009. The SME's share of business financing provided by financial institutions increased from 21.2 percent in 1996 to 39.8 percent at the end of June, 2010. Micro financing outstanding through financial institutions grew rapidly form RM 84 million in 2006 to RM709 million at the end of June, 2010. These aggregates place

Malaysia among the top 10 countries out of 139 ranked by the World Economic Forum in terms of "Ease of Access to Loans".

ii. Financial Inclusion in India[5]: Financial inclusion is integral to the inclusive growth process and sustainable development in India but it is still an emerging concept. The Minister of Finance, Pranab Mukherijee explained that 80 percent of the public sector banks (PSBs) have already adopted the core banking solution that integrate financial inclusion, the remaining 20 percent are still being persuaded to do the same.

The major focus for lending in India is the small and medium scale enterprises (SMEs) as these are considered vital to fuel the engine of growth of the country. Lending to the SME sector surged from around Rs 36 billion in 2006 to Rs96.5 billion in 2010 with the lending ratio rising from nearly 8 percent to 29 percent in 2010. According to various estimates the SMEs sector contributes around 30 percent to the GDP and new incentives to the banking sector are being introduced to increase the size of the SME financing portfolio which at present is around 10 percent of the total bank lending.

There is also Kshetriya Gramin Financial Services (KGFS) which is a rural financial institutions outfit with the following characteristics:

- Limited geographical focus serving all households and enterprises' needs;
- Offering multiple basic financial services for clients;
- Thin front-end branches with process standardization, and backed by robust banking software and connectivity; and
- In-built biometric technology to build client history and lower transaction costs.

The KGFS has Wealth Managers who advise households and enterprises based on understanding of their needs and risks, as well as provide incentives to maximise the clients' financial wellbeing which the KGFS realise is the key to boosting its long-run returns. There is also Network Enterprise (NE) Approach which is a supply chain-specific investment fund. The approach assists in (i) directing investment in

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[5] Information was obtained largely from IFMR Trust's Chairman of Advisory Council, 2008.www.nachiketmor.net

model enterprises and common back-end investment such as rural tourism, (ii) accelerate the supply chain and unlock debt capacity of individual enterprises, and (iii) use of equity capital higher up in the supply chain to estimate and reduce risks.

Despite the improvement made with ratio of one bank branch to 16,000 people, there is still a long way to go. The Minister of Finance urged banks to come with definite financial inclusion plans and the need for robust electronic transfers between bank branches located in the rural hinterland in order to make income and financial transactions seamless. Also, the Chairman of the Confederation of Indian Industries Taskforce on Financial Inclusion, Mr. Sinha informed that financial illiteracy is a key stumbling block to furthering financial inclusion. He believed that a pro-active approach will see the banking network expanding in an all-inclusive manner like the telecom sector.

The above takes us to the core of this paper which is looking at the challenges and prospects of financing inclusive growth in Nigeria.

V. Financing Inclusive Growth in Nigeria: Challenges and Prospects

The Challenges

i. We posited in the introductory section that Nigeria has not been consistent in charting its economic growth through development programmes grounded in systematic theoretical construct or planned path. The country's growth paths vacillate between received or externally induced growth programmes and so called 'home-grown' programmes. This inconsistency in policies provides a great challenge to developing financial architecture to support the growth programmes. For instance, the current national development programme couched Vision 20:2020 is not explicit on the kind of growth model the country is pursuing or that the Vision recognises inclusive growth as its official growth path (even though 2012 budget is hinged on inclusive growth).

If this is so, why is the Central Bank planning to finance inclusive growth? That is, the country must come out clearly to state that it has adopted inclusive growth model of development with adoption of appropriate policy measures. This is with the recognition that inclusive growth is a medium to long-term growth agenda and the CBN can then provide the financial architecture to achieve these.

ii. There is need for a strong and well developed and respected financial sector. Presently, there are institutional restrictions on financial institution spread across the country, resulting in high ratio of bank branch to population. Actually, the rural areas lack financial institutions and attendant financial services despite all efforts in the past geared towards monetising the rural sector. The financial sector is still under-developed not only in terms of spread but also in terms of array of instruments for operating the markets.

iii. Some intermediate financial institutions have been undermined and derailed. For instance, such financial institutions cooperative banks, community banks and specialised banks which are necessary intermediate inputs in financing inclusive growth have been negatively affected by corruption and financial reforms that created mega banks in 2004 without any regard for small and medium scale banks.

iv. Two key areas where inclusive growth policy should touch for efficiency and effectiveness are the agricultural sector and the SMEs. Both are facing challenges of neglect of policy implementation to the extent that they themselves need some transformation before finance can reach and assist them. While agricultural development requires land reform and education for large scale mechanised farming to take place, the SMEs are seriously affected by infrastructural decay, particularly availability and cost of energy.

v. The illiteracy level in Nigeria is very high such that almost half of the population have little or no education. Inclusive growth requires that large percentage of the population should be educated to be able to benefit from the attendant financial inclusion, which is key to its success.

vi. Public trust in the financial system has waned. This is particularly true for the under-served segment of the population who have at one time or the other suffered from liquidation and closure of some of the financial institutions (rural banks, peoples' banks and community banks or micro finance banks) with loss of their money. Re-establishing such institutions for the purpose of financing inclusive growth may not elicit understanding and support from this segment of the population. This is in addition to reports of bank robbery every now and then with concomitant perception of insecurity of depositor's fund. Lots of education and public relations will be required to change peoples' mind.

vii. The banks and other financial institutions, which are largely private sector business may not be easily convinced to adopt core banking solution that can enhance the success of inclusive growth. This in essence will affect the depth for financing inclusive growth. More so, financing inclusive growth requires medium to long term fund but most of our banks, including community and micro-finance banks, operate at the short end of the market to meet the profitability requirements of the shareholders.

viii. The issue of corruption and lack of corresponding measurable punishment that can serve as deterrent for future offenders. This has permeated the financial sector to the effect that people have lost interest in voluntarily keeping their money in banks as it creates fear in the public that their hard earned money may disappear, thus, preference to keep their money at home. Also, many corruptly enriched individuals now build vaults at home and keep both local and foreign currencies therein. This invariably makes it impossible for the CBN to know the actual money in circulation and affect money in circulation with concomitant multiplier effects.

ix. Inaccurate data also constitutes problems to planning. Although there has been, over time, improvement in data gathering, there is the need for the Central Bank and the Federal Bureau of Statistics to work together to present single data in many cases rather than disparity in data on the same variables from the two institutions.

The Prospects

The fact that we have been able to identify some challenges that can work against financing inclusive growth implies that the problems are half solved. It is not that the environment is totally not conducive to the promotion of financing inclusive growth, because some facilities and opportunities can be harvested to support the programme.

i. Employment generation, improved productivity and personal income enhancement are integral part of the current development agenda: Vision: 20:2020. This implies that the basic ingredient of inclusive growth, though not so emphasised, are already being implemented within the Nigerian growth model. The Central Bank can, therefore, persuade the operators in the financial system to key into the financial inclusion aspect of the Vision.

ii. The commercial banks with their network of branches can easily serve as the transmission route for providing finance to the under-served and vulnerable through special intervention funds provided by the Central Bank, Bank of Industry and other specialised banks.

iii. The strengthening of micro-finance banks through regulation and supervision, as well as their growth into rural communities provide additional institutional framework for financing inclusive growth.

iv. There are many cooperative societies, including interest free ones like Al-Hayat Foundation and As-Salam Foundation fashioned after Interest free banking, that are highly patronised by many small scale enterprises. These can also form nucleus of grassroots financial institutions for financing inclusive growth.

v. The automation of banking services through e-transact, particularly fast adoption and distribution of ATM and money transfer facilities have improved access to banking services.

vi. The rapidly growing use of cell phones and internet facilities have laid foundation for overcoming the spread of banking services to the underserved areas and involving even the urban poor. The need to use these facilities for banking services from now is imperative.

VI. Summary and Recommendations

This paper looks at challenges and prospect of financing inclusive growth in Nigeria. We review growth models from the classical to the endogenous and inclusive growth. It was posited that it is more often than not difficult to pin down various Nigerian growth and development programmes on any theory. Theory forms the basis for conceptualisation, measurement, evaluation and redesigning of the programme as implementation progresses.

Furthermore, we posit that there have been policy inconsistency rather than policy sustainability in the Nigerian economy. An example is the present situation where the same political party has been ruling at the federal level since 1999 when the country went back into democratic form of government yet we have had three different and seemingly independent growth policies namely NEEDS, 7-Point Agenda and now Vision 20:2020. This inconsistency does not augur well for a country desirable of making appreciable growth within the shortest time possible – 20:2020. In addition, we do not know the place of inclusive growth in the Vision 20:2020 development programme.

Notwithstanding the shortcomings that we noted above, it is desirable that an important policy organ like the Central Bank can direct or re-direct the Vision towards inclusive growth that has assisted many developing and emerging countries to overcome the issue of chronic poverty in recent times. Christine Lagarde, the new International Monetary Fund Managing Director, indirectly indicating the important role of central banks in economy policy formulation and implementation of countries said *inter alia.*

> In the event of a sharp downturn, the key will be to protect vital spending to mitigate the impact on growth, and to protect the most vulnerable. Because the scope for countercyclical fiscal policy has become more limited, monetary and exchange rate policy could be used more actively …When growth is strong and external conditions are favourable, it makes sense to rein in deficits and shore up reserves. This builds a cushion for the bad times and especially for protecting the most vulnerable (Lagarde, 2011).

It is important at this stage to propose the following as recommendations:

- The Central Bank may of necessity make the government to come out clearly in support of inclusive growth as a medium to long term growth strategy so as to sensitise the financial institutions to the need to have financial inclusion policies within their policy thrusts;

- The CBN itself will need to provide specific and general policy framework for financing inclusive growth in Nigeria, borrowing from the experience of other countries. This is an important assistance to the finance industry given the dearth of manpower to do same in the sector. Adoption of the policy can start with moral suasion;

- The CBN, in partnership with the capital market and the insurance industry, can work together to promote financial inclusion policies within the financial sector and among the real sector operators;

- The community banks and MFIs currently operate in the short end of the financial system, serving mainly as treasury or payment outlets for public and private institutions' workers. They should be strengthened, policy-wise, and with some incentives to extend their services to the medium and long term end which will be beneficial for financing inclusive growth;

- The CBN could partner with the Ministries of Education, Labour and Development Planning on organising workshops for workers, artisans and tertiary institution students on entrepreneurship, the art of financial management and planning;

- There is the need to re-invent the specialised banks for agriculture and cooperatives and that of small and medium scale enterprises;

- The numerous cooperative societies need a form of coordination that cooperative banks used to provide. A desired and deliberate effort to provide meeting point/coordination for these societies will enhance financing of inclusive growth, and

- It is also envisaged that the introduction of Islamic banking with interest free loans and potential joint venture projects that do accompany such type of bank could serve as impetus for rapid financing of inclusive growth in Nigeria. This has been the case with Malaysia which is one of the countries in the world with astounding financial depth and rapid industrial growth.

These suggestions are not exhaustive but they are meant to point out that financing inclusion is do-able and achievable if Nigeria decides to adopt inclusive growth as her path to economic development. Realising that inclusive growth path to development is a medium to long-term programme, patience, policy consistency and sustainability should be the watchword. Very importantly, we need to understand and take note of the import of the quotations (preceding the introductory section of this paper) from Christine Lagarde (2011) concerning economic diversification taking advantage of rising incomes from our natural resources and Dinesh Krishnan (2011) on the role of mobile banking and cashless payments for successful financial inclusion.

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Financing Inclusive Growth in Nigeria: Challenges and Prospects

Patrick I. Esenwah

I. Introduction

Chambers Dictionary, 20th edition, defines Growth as something that has life and is growing or has grown; gradual increase; progress; development; increase in value. It could be in the context of social or economic growth. Social growth means maturing and developing one's skills and learning better how to get along with others. It could also be looked at from the norm and cultural perspectives in appreciating how events which seemed to be primitive in the past are now being done in a more civilized way or fashion.

In Economics, Economic Growth (EG) is defined as the increasing capacity of the economy to satisfy the wants of the members of society. Economic growth can be appreciated by increases in productivity which lowers the cost/input of production, e.g. labour, capital, material, energy etc., for a given amount of output. Economic growth is usually in the long-run provided it is not disturbed by wars, political/religious conflicts or upheavals capable of changing the drivers and leaders of the process.

Inclusive Growth (IG) is growth in its entirety, holistic and comprehensive, including everything. It could be broad-based growth across sectors, shared growth and pro-poor growth. Inclusive growth can be described as economic growth with widest participation and benefits best shared through equal opportunities. It is concerned with opportunities for the majority of the labour force, poor and middle-class alike to participate in the production of goods and services rather than in income redistribution as was done in India some years ago. Inclusive growth is a means for rapid and sustained poverty reduction. Emphasis is on equality of opportunities in terms of access to markets, resources and unbiased regulatory environment for businesses and individuals. In short, Inclusive growth is about raising growth levels and enlarging the size of the economy while providing a level playing field for investment (productivity growth) and increasing employment opportunities.

It is important to note that IG must be tailored to country-specific circumstances. It is market-driven with government playing a facilitating role.

To better understand Inclusive Growth, it may be desirable at this point to explain what Financial Inclusion (FI) is. FI is defined as the provision of access to a wide range of financial services to everyone that needs them. Such financial services include credit, savings, payments, leasing, insurance and financial advice. It is also the delivery of banking services to the vast sections of disadvantaged and low income people.

About 38 million (46.3 per cent) of adult Nigerians are excluded from financial services (EFInA Survey 2010). In South Africa, Kenya and Botswana, it is 26.0 per cent, 32.7 per cent and 33 per cent of their adult population, respectively. These are lower than Nigeria. Achieving IG therefore, will require a corresponding growth in FI.

Deriving powers from its developmental function and its unique position to influence players in the financial system, the Central Bank of Nigeria (CBN) has been promulgating policies, issuing guidelines and playing vital intermediation roles on FI and IG in Nigeria. Many countries in Africa, Asia, Eastern Europe, The Caribbean and South America also engage in promoting FI and IG in their respective countries either directly by their central banks or through specialised development banks/institutions. Such countries include: Indonesia, The Philippines, India, Bangladesh, Croatia, Turkey, Kazakhstan, Colombia, Brazil, Mexico, Ethiopia, Kenya, Uganda, Mauritius, South Africa, Ghana, Sierra-Leone and The Gambia, to mention a few.

II. Functional Sectors Necessary for Inclusive Growth

Growth has to be holistic for meaningful development. For an effective IG, polices must be tailored, by governments, to develop as well as ensure appropriate finance to the following sectors, among others.

II.1 Agriculture

It contributes about 26.8 per cent to GDP; 66.0 per cent of Nigerians are engaged in it; source of income and raw materials for industries (SMEs and LSEs);

value-chain development etc. The massive land areas as well as huge mineral and agricultural potentials to explore are an advantage.

II.2 Small and Medium Scale Enterprises (SMEs)

SMEs are viewed as engine of growth of any nation. SMEs feed Large Scale Enterprises (LSEs); Ensure backward integration e.g. promoting other businesses such as: cement, paint, steel, carpet making, construction materials, agribusiness, e.t.c., in a SME cluster/environment with one another. Another example is in Japan where SMEs feed LSEs of car manufacturing companies with spare parts components.

-Infrastructure-Development of rural/urban facilities like roads, railways, ports, water, energy/power etc.

-Education: Capacity building/Training, improved financial literacy rate, free education and scholarships, consumer protection mechanism etc.

-**Health**: Health is wealth, so good health facilities for all, free/affordable medical facilities and Insurance.

-Housing/Environment: Provision of good and affordable houses, healthy, safe and clean (sanitary) environment as well as mortgage finance and home loans.

-Security: Safety of lives and properties, stable political/democratic environment etc.

-Legal/Land reforms: Credible legal processes, rule of law, human rights, title deeds for physical development.

-**Research and Development**: Accurate, reliable and timely availability of data for planning and implementation of programmes.

III. Financing Inclusive Growth (IG)

IG is a panacea for poverty reduction and economic growth of any nation. Unfortunately, funds/finances have always been limited for its impact to be felt. Governments (State and Federal) make huge annual budgetary provisions to finance or develop the above-mentioned components, necessary for IG. The extent to which these budgets are implemented called for concern.

Individuals who are also involved in promoting IG need to be able to prepare bankable and feasible proposals to attract loans, grants or aids. Usually, collaterals especially the possession of title deeds and tangible properties are required, to back-up loans in case of default.

For a good bankable proposal or feasibility study, it is important that the entrepreneur considers the following to attract lending/finance by the bank. They are usually called the five Cs of credit: Character, Capacity/Capability, Condition, Capital and Collateral. In considering these, the physical, technical, marketing, social-economic and financial aspects of the project must also be addressed.

1. Sources of Finance For The Inclusive Growth Components:

Two major sources: Formal and Informal

(a) Formal Sources: - banks deposit money banks (DMBs), Micro finance banks (MFBs), MFIs, DFIs (BOI, BOA, FMBN), capital markets, international donor agencies/partners, UNDP, IFAD, JICA, GIZ, USAID, Ford, Bill and Mellinda Gate and Foundations.

CBN intervention funds and programmes such as the Agricultural Credit Guarantee Scheme Fund (ACGSF) established in 1977 to guarantee loans granted borrowers by banks in case of default. It guaranteed 757,075 loans valued ₦53.18 billion since inception to March 2012; Agriculture Credit Support Scheme (ACSS) established in 2006 with ₦50 billion; Commercial Agricultural Credit Scheme (CACS) established in 2009 with ₦200 billion. Had disbursed ₦175.52 billion to 222 beneficiaries including 29 state governments as at March 2012.; SME Credit Guarantee Scheme (SMECGS) established in 2010 with ₦200 billion. Had disbursed ₦1.03 billion to 20 projects as at March 2012; SME Refinancing and Restructuring Facilities (SME-RRF) established in 2010 with ₦200 billion. Had disbursed ₦225.64 billion to 487projects as at March 2012; and the

Power and Aviation Intervention Fund (PAIF) established in 2010 with N300 billion. Had disbursed ₦159.14 billion to 27 projects as at March 2012.
The CBN also introduced the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) in 2010. The concept is to de-risk the agricultural and financing value-chains to encourage quality lending to agriculture. NIRSAL programme also aims at increasing bank lending to agriculture from the current 2.0 per cent of total bank lending to 10.0 per cent over seven years.

Other policies/products being developed by the CBN to ensure FI and IG are the granting of Mobile Banking License to stakeholders, the Non-Interest Banking model and other banking reforms. These are aimed at strengthening and stabilizing the financial sector.

These schemes are operated with direct collaboration with banks (DMBs, MFBs/MFIs and DFIs) and the Federal Ministry of Agriculture. The detailed performances of these products are available on the CBN website: www.cbn gov.ng and those of the respective banks/institutions mentioned.

(b) Informal Sources: - Personal savings, co-operative societies, self-help groups, money-lenders, families, friends etc.

2. Practitioners of Inclusive Growth (IG) :

For an effective financing of IG in Nigeria, the following, among others, should be reached or targeted**:**

- Human Targets: youths, employed and unemployed, school-leavers, women, farmers (peasant and commercial), entrepreneurs (Micro, Small and Medium Enterprises-MSMEs), Large Scale Enterprises- (LSEs) and industrialists, pensioners, transporters etc.

- Institutional Targets: government organizations, organised private sector (OPS) practitioners, trade unions etc.

III. Challenges of Financing Inclusive Growth (IG):

The following, in no particular order, are some challenges that may affect the flow of credit or finance to enterprises that would accelerate economic or inclusive growth. They are:-

- Banks' unwillingness to lend to the poor except to mobilize deposits from them and lend to high profile portfolios and invest in capital and foreign markets.

- Inadequate funds/capital to lend, low capital base of many financial institutions, poor savings culture and mobilization, thus reducing cheap and stable fund for the productive sector.

- High cost of funds (interest rate), high inflation and foreign exchange rates, high rate of financial illiteracy, low bank branch/retail penetration, lack of adequate payment system infrastructure, absence of a wide variety of alternative modes of financial intermediation e.g. capital market and inadequate consumer protection mechanism to encourage lending/borrowing.

- Inadequate collaterals for big loans and meeting the obligation of the guarantee by borrowers who aim at growing the economy.

- Poor provision of enabling environment (level playing field) by government to maximize production prices and create employment; failure of which leads to inflation, poverty, disease, hunger, anger and terror on fellow citizens.

- Filthy/dirty and unhealthy dwelling environment (to live and work) to ensure soundness of mind, good thinking, innovation and productivity, contrary to what exists in more developed countries.

- Inadequate financial skills and inability to identify/present bankable and feasible projects for finance. There is that tendency to propose grandiose, non-grass root, non-felt need and non-poverty eradication-oriented projects.

- Some bank staff also lack skills to analyse and develop bankable projects as well as develop products tailored to meet the exclusive group.

- Poor infrastructure and difficulty of doing business in Nigeria e.g. high electricity tariff or provision of energy for MSMEs, lack of good roads, water, market, communication, poor legal framework for equity and justice.

- High credit risk arising from high default rate (deliberate default, climate change and natural disaster causes). Other risks include: market, operational and liquidity risks.

- Insecurity of lives and properties, incessant tribal, political, religious wars or disturbances.

- Poor co-operative culture among Nigerians to form businesses, develop and sustain them.

- Poor corporate governance and weak internal controls/audit systems of financial institutions and businesses.

- High incidence of fraud, bribery, nepotism, tribalism and corruption which compromise trust as well as confidence in the society.

- Impunity and lack of sanctions on erring persons/organizations.

- Discontinuation of projects/programmes (abandoned projects) by new governments or organizations thus leading to financial drain - pipes and wastes.

- Improper planning, monitoring and evaluation of programmes by government, (especially in areas of comparative advantage) which could attract funding.

- Under-developed micro-insurance and micro-housing finance/mortgage schemes.

IV. Way Forward

It is important that governments, individuals and organizations concerned provide the following to enable holistic growth, economic growth, inclusive growth and the attendant financing. They include:-

i. Providing more funds, loans, finances to the productive sector including housing mortgage. Need for early operation of the long proposed National Micro-finance Development Fund (NMDF) of the CBN.

ii. Financial literacy. Enlightenment on how to prepare bankable projects, sources of finance and how to manage them, proper market channels, value-chain management, consumers protection rights etc.

iii. Establishment of Entrepreneurship Development Programmes and Centres to develop business skills, models, education, knowledge and information.

iv. Properly equipping financial institutions with quality staff, train, re-train and retain them as well as ensuring appropriate rewards /sanctions.

v. Providing technical assistance and market linkages for MSMEs.

vi. Effective regulation and supervision of banks by the CBN would ensure sound and stable financial system. The banks/MFIs would thus be able to absorb stress/shocks and lend to enterprises that would promote growth in the economy. Furthermore, the CBN should strictly embark on full regulation and supervision of mobile banking services and electronic payment system /devices, e.g. ATM, Internet (on-line) banking, points of sale (POS) terminals/services, now operational in the financial system, if it has not commenced it.

vii. Agent banking should be introduced, as early as possible, to complement other financial products/services.

viii. Appropriate organs of government should be able to provide incentives to investors in the form of genuine capital grants, tax holidays, export rebates and liberalized Visa regimes by granting long term (5 to 10 years) visas to genuine and frequent investors travelling to Nigeria.

ix. Efforts should be made by all to promote savings so as to free more money for investment, economic and inclusive growth.

x. Promoting micro-insurance for MSMEs and micro-housing/mortgage schemes for safety and good health of majority of urban poor/dwellers to enable them give their best in innovation and production.

xi. Ensuring good governance and ethical practices at all levels of governments and corporate organizations.

xii. Strengthening partnership/collaboration with best global partners/ organizations to up-scale Nigeria's standards.

xiii. Consistent government policies and completion of physical projects or programmes of past governments by new governments. No more abandoned projects to ensure continuous growth.

xiv. Proper planning, monitoring and evaluation of projects/programmes by governments especially in areas/sectors of comparative advantage to them.

xv. Developing infrastructure for businesses to thrive, create employment and particularly engage youths and women.

xvi. Providing and ensuring adequate security for all by government.

xvii. Combating/Fighting fraud, corruption and other socio-economic vices and crimes, without discrimination, to ensure trust and confidence in the business environment.

xviii. Everyone should work assiduously and patriotically, devoid of profligacy and ostentatious living amidst the majority of the poor in the society.

V. Conclusion and Prospects

Nigeria needs a holistic, an aggressive and sustainable growth in all sectors of the economy. These sectors need financial support through government, individuals and strategic partnership with foreign donor agencies and institutions. However, prudent and sincere application/utilisation of these financial resources will ensure effective FI), IG and EG.

Effective IG and EG will provide gainful employment, develop MSMEs, halt rural-urban migration and forced slave labour outside the shores of the country, which led to the embarrassing repatriation of some Nigerian youths from some African and European countries recently. Financing IG and creating awareness to the financially exclusive persons is paramount for socio-economic development of Nigeria.

Sustainable IG and EG would promote export of goods and services, foreign exchange earnings, foreign direct investment (FDI) and remittances from Nigerians in the Diaspora to Nigeria. These will improve the general standards of living of parents and relations at home, health and housing, infrastructure and reduce the poverty level.

With continuous and appropriate banking reforms and sanity in all sectors of production, peace and stability in the country, political will by government to finance IG, Nigeria would be able to achieve its Vision 20:2020, the Millennium Development Goals (MDGs) and the Transformation Agenda of government, timely. Nigeria has huge human and vast physical resources to explore, to achieve greatness.

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