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EFFECTS OF REGULATORY CONTROLS OF THE CENTRAL BANK OF NIGERIA ON FINANCIAL STABILITY IN NIGERIA

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ABSTRACT

The article examined the effects of the regulatory controls of the central bank on financial stability in Nigeria. The events that eventually led to the establishment of the central bank of Nigeria were highlighted .The functions of the central bank and its regulatory controls were discussed , events such as the change of currency in 1968 during the civil war, the change from pounds to Naira in 1973, the foreign reserve crisis of the late 1970s, as well as the currency redesign of 1984 and 2022 were also mentioned. It was concluded that the regulatory controls of the central bank has helped in providing financial stability in the Nigerian economy over the years. Strengthening of regulatory control as regards the establishment of commercial banks as well as not creating higher denomination of currency such as 2000 and 5000 Naira notes in the near future so as to help control inflation were recommended.

Keywords : Regulatory , Controls , Financial, Currency , Stability , Nigeria

1.0 INTRODUCTION

Banking generally is as old as western civilization. The first bank to operate in Nigeria was established by Elder Demster and the second which followed in 1892 was the African Banking corporation. By 1948 the number of commercial banks had risen to an extent that the need to police their activities had become obvious. There was a monetary authority to perform this vital function but because it was a colonial financial institution whose interest in a systematic economic development of the colonies was a negative one and, for the fact that it was responsible for all the financial affairs of the then British west Africa- Nigeria,, Gold Coast (Ghana) Sierra Leone and Gambia, it was so much burdened to consider regulating banking operations in any of these colonies. It can therefore be said that the West African currency Board from which the central bank took over in 1959 did not attempt to interfere in the affairs of the commercial banks throughout its existence from 1912 to 1959. In all the countries where commercial and other banks operate under the surveillance of central monetary authorities the need for regulating operation openly manifested itself before such controlling authorities were established. Even the USA which established her central Reserve Bank as far back as 1913 did so out of this sheer need. To oversee and regulate the activities of the commercial banks. As the number of the commercial banks grew between 1930 and 1940 with corresponding rise in malpractice the regulations became wider in scope and more stringent in nature.

The need to establish a central monetary authority to control , direct and even to assist the commercial development of Nigeria had begun to be felt as far back as 1948 and to meet that challenge the colonial Government commissioned one Mr. Paton to examine the whole banking system in the country and his report in 1952 recommended among other things the establishment of a central Bank after a three year grace for the commercial banks to get prepared for the rules and regulations under which they would operate. During this period of grace from 1948 to 1952 many more mushroom banks sprang up and the need for an authority to go between them and the depositors became glaringly apparent because they all had the sole aim of profit maximization to the detriment of liquidity for their depositors.(James, *et al.,* 2011; Camdessus, 1995 and Eichegreen ,1998). It therefore goes without saying that the central bank occupies a lofty position in the economy of any country.(Ocheja, 1983). Williams Rogers once said, there have been three great inventions since the beginning of time: fire, the wheel and central banking. Also the pomp and pageantry that accompanied the opening of our Central Bank on 1st July, 1959 is a mark of its importance in the economy and the following excerp from the historic speech by the former Federal Minister of Finance, Chief Ekotie -Eboh on the occasion of the opening ceremony of the central bank of Nigeria is indicative of that importance: "Today will go down in the annals of this country as a most notable day. For me it will be an everlasting honour that it should fall to my lot to be Minister of Finance on this occasion. History is being made and I am humbled by the thought that in the days to come my name will be linked with today, the first July, 1959. The establishment of a central bank and the issuance of a national currency were placed before me as my first major assignment when I took office as Minister of finance."(CBN, 1979). Given the importance of financial stability in any country (CBN, 2015) , highlighting and analyzing how the control measures are carried out by the central bank as well as their effects on financial stability in Nigeria will not be out of place

2.0 MATERIALS AND METHODS

Literature on the cenral bank and its regulatory control and their effects on financial stability in Nigeria were assembled from Journals , conference proceedings, Bulletins etc were assembled , collated , analyzed and discussed.

3.0 RESULTS AND DISCUSSION

3.1 Functions of the Central Bank

The broad areas, namely, the traditional function of the central bank imposed on it by the central bank Act of 1958 and the developmental promotion functions which were later added on the dictates of our economic development realities will be examined

1) Statutorily the central bank is the sole issuer of our legal tender currency-the Naira notes and coins. In this capacity it arranges for the printing of the currency notes and the minting of coins according to approved specifications-size, weight, composition, units and denominations. After the historic issue of Federation of Nigeria currency to replace those of the West African Currency Board in 1959 when the Central Bank was born has on a number of occasions caused to be issued currency for different economic and political reasons. Nigerian Currency was issued in 1965, 1968, 1973 and 1979. Because of its economic and political implication the change of currency in 1968 and 1973 will be mentioned later in detail.

2) Central Bank acts as banker, financial and economic adviser to the Federal Government. As such it receives deposits and effects payments on behalf of Federal Government. It is also at the disposal of State Governments and parastatals which may want to use its banking services. To meet temporary deficits the central bank provides "ways and means" advances to the Federal Government. It issues and underwrites short term, medium and long-term securities such as treasury bills, certificates and development stock on behalf of Federal Government. Federal Government fiscal policy guide lines emanates from the bank's advice. As a bankers' bank it keeps the accounts of commercial, merchant and development banks.

3) In order to safeguard the international value of the Naira central bank maintain foreign reserve and for the same reason it controls foreign exchange.

4) Central bank promotes monetary stability and maintain sound financial structure in Nigeria.

3.2 Developmental Promotion Functions

From 1959 the Central Bank has been known to be in the fore – front in the race for economic development of this country. It has directed all the commercial banks to extend their branches to the rural areas. It has helped in a number of ways in the implementation of our indigenization policy. Its promotion of agriculture, residential house construction, transportation, road construction and indigenous small scale enterprises cannot be over – emphasized. To ensure rapid development in these sectors it issues guidelines to commercial banks that the bulk of their sectoral credit should go to these preferred sectors of the economy.

3.3 Central Banks Regulatory Controls and Effects on Financial Stability

Before the establishment of the central bank in 1959 there were the standard bank of west

African. (First Bank) Barclays Bank and African Continental Bank. To name but a few. In the absence of any restraining rules African Continent Bank lent out so indiscriminately that its cash vaults soon became empty. Some political big shots took huge amount of loans, advances and turned round to say they could not repay the loans. The bank's liquidity obligation to its customers could not be met. The share holders did not fare better either. This unethical affair came to a climax in 1957 but Federal Government, much as it wanted to step in, had to wait for the necessary banking legislation which was eventually passed in March, 1958. One of the most significant aspects of the Central Bank Act of 1958 was the clear stipulation that commercial banks .must 20% of their deposits liabilities with th central bank. This regulation is still very much in force. Today, all commercial bankers must deposit 20% of their respective deposit liabilities with the Central Bank. This is to ensure that depositors can have something to take home whenever they come to their bankers to withdraw some money from their accounts. Also if commercial banks are allowed to keep all their deposit liabilities they may be tempted to give credit indiscriminately and this can lead to inflation. The Central Bank, by keeping part of the commercial banks' deposits ensures protection of the customs' interest and it also brings about the much desired financial stability in the country.

During our short-lived oil boom of 1973 to 1976 excess liquidity was common among the commercial banks to the glaring extent that it threatened inflation and as a result the central bank had to do some mopping by issuing guidelines to regulate both the total and sectoral distribution of the commercial banks' credit, directing larger parts of their loans to preferred sector of the economy such as agriculture, residential building construction, road construction, transportation, export-oriented business, indigenous small scale enterprises and agro-allied industries. Loans to agriculture and housing have become so mandatory on commercial banks that where there are shortfalls should be deposited with it for eventual loans to Agricultural and Co-operative Banks and Mortgage Bank of Nigeria. Indeed, the Central Bank seems to have unlimited ways of controls aimed at stabilizing our finances. Sometimes if government senses inflation it causes money "to return" to the vaults of the banks by raising interest rates on loans whereby people will prefer to deposit huge amounts in their savings accounts and spend less. Alternatively if interest rate is reduced customers prefer to put their money into circulation-investments for profits other than interests. One other instrument of control by the Central Bank is its rate of discount on loans to commercial banks. If the Central Bank wants to put a lid on money supply for fear of possible inflation it may substantially raise the rate of discount and this will accordingly discourage the commercial banks from borrowing Central Bank. When Central Bank has no good reason to restrict the amount of money in circulation it may reduce the rate of discount to enable them borrow and the commercial banks will in turn be able to loan out money to customers. According to the News watch magazine of 25th April 1988, Nigeria was surviving on over draft as at the first quarter of 1988, to reduce the burden the government had to borrow locally by issuing treasury bills By its Open Market Operation method the central bank deals with sales and purchases of securities such as treasury bills, certificates and stock exchange. When any of these securities is bought by the Central Bank it means more money in its coffers and by selling, it disposes of money. This means that money can be enlarged and contracted as the economic situation demands and all is aimed at ensuring financial stability. Other stabilization techniques include the raising or lowering of the minimum amount of cash down payments for the purchase of such things as real estate, stock from the Stock Market and minimum period of maturity for credit to customers. Others are rediscount rate policy, special deposits, moral suasion, cash reserve requirements and call money scheme.

3.4 Some Residual Powers of the Central Bank

The Central Bank has a considerable number of powers at its disposal to apply in controlling instability, inflation or any other unhealthy economic phenomenon. Such powers, although not apparent, are very effective and they emanate from its traditional functions of the right to issue currency, to act as banker and financial and economic adviser to Federal Government, promoting financial stability and maintaining foreign reserve to safeguard the external value of our currency. One of its such powers was used to the advantage of our economic stability in 1968 when the civil war with the secessionist Biafra was fiercely raging on. Government had imposed trade embargo on Biafra. Soldiers had looted the un-issued currency from the Central Bank branches at Enugu and Benin City and the money had been into circulation. Some scoundrels were also busy trafficking in the Nigerian currency abroad. To deal effectively with these situations, the Central Bank issued new currency that was different in all forms from that in use before 1968. The secessionists were dumbfounded and those who looted money from Enugu and Benin City could not use it and those who traded in the former currency had to stop. There is hardly any need to say that this singular act averted what would have happened to the value of our currency if the situation had been allowed to continue longer than it had done.

By 1973 Nigeria had realized that many foreign countries with which she had trade links both in Africa, Europe and America used decimal currency and if those trade links should continue, our currency should be brought in line with their own currency so that possible losses in conversion should be avoided and also to streamline the process generally. In order to do this the Central Bank caused the Naira and Kobo to be printed, minted and issued for use in the country. This is how Naira and Kobo came to replace our former pounds (sterling) shillings and pence. This change, no doubt, augured well for stability because it ensured that in exchanging our currency for the foreign ones losses were not incurred.

In 1984 the then military head of state ordered the redesign of our currency(the colors were changed) to protect the economy and also render useless monies stolen by politicians during the civilian rule from 1979 to 1983, similarly there was currency redesign in 2022 during the Buhari Presidency, to control inflation and also help curb vote buying during the 2023 general elections, there was also an attempt to introduce a semi cashless policy to reduce the spate of armed robbery and kidnapping ,as usual the central bank was the implementation agency.

The Central Bank in its position as master banker carries out monthly inspection of the books of commercial, merchant and other banks to ensure that they comply with banking regulations as stipulated by the Central Bank act of 1958 and the subsequent ones. Any bank found defaulting will have its license seized. The bank does not only do this but it sometimes advises and assists in the management of the affairs of the commercial banks. This advice and assistance do earn the Central Bank respect which also goes a long way to ensure that its rules and regulations are religiously observed.

3.5 Control through Management of Foreign Reserve

From the time the Central Bank took over from the defunct West African Currency Board it automatically assumed the responsibility of maintaining and managing our foreign reserve. As manager and custodian of our foreign reserve, certain regulatory powers are vested in it from time to time by different Government legislations. Thus the Act of 1962, that is, the Exchange Control Act of that date gave the bank powers to be the sole controllers of all the proceeds of exports. This same act received more impetus in 1967 and centralized all foreign reserves in this bank and by the time our foreign exchange earnings from crude oil had risen to a tremendous amount the bank was in control of very huge amount which for the purpose of liquidity and security was banked in U.K. and New York. Certain unfavourable developments later forced the Central Bank to exert its powers. There was uncertainty and fluctuation in the foreign currencies generally as from 1974. Also Nigeria – Great Britain relations were severely strained after the assassination of General Murtala Mohammed, the then Head of State and Commander In-Chief of the Armed Forces. Nigerian Government and citizens suspected that Britain had connived with Dimka and his rebel group who escaped to the Britain High Commission in Lagos after the assassination. Coupled with the fact that General Gowon, his mentor was in U.K. the suspicions became too deep-rotted to be dislodged. Nigeria feared that if the situation deteriorated U.K. might freeze our accounts.

To forestall therefore, this dangerous situation, central bank carried out with dispatch government directive to withdraw a bulk of money to be deposited in France, West Germany, Sweden and Japan. Some other economic reasons have been given as a cover up but this is the real reason for distributing our foreign reserve as at that time - 1976. The economic reason given was that the transfer and distribution would facilitate payments for our imports and also payment for sales of our crude oil.

Just as the central bank was called upon to manage the proceeds from the oil boom 1973 - 1976 it later fell to its lot to deal with leam years that followed. As from 1978 Nigeria's balance of payment was in a mess. After a record surplus in 1974 and 1975 our balance of payment changed into a deficit of N340.00m in 1976 and went up to N447.00m in 1977 and it could have reached a record level of N1, 382 million in 1978. It could have reached a staggering level of about N2 billion if a loam of N883.4 from Euro currency market had not come to save the situation. With the loan our external reserve stood at N1,361 million at the end of 1978. To bring this ugly trend under control Government promulgated the pre–shipment inspection Decree. The decree introduced comprehensive imports supervision scheme in January,1979. The scheme was designed to do away with some mal practices such as:"over-invoicing for the purpose of transferring foreign exchange abroad; under-invoicing of imports for the customs purposes, that is for paying less duty; the importation of obsolete plant and machinery; the importation of decayed or rotten food items and time expired drugs; falsification of document generally and foreign exchange claims for goods not imported or services not rendered". What all these vices meant was that the cost of importation sky-rocketed to the detriment of the production sector. The scheme which was carried on by the central bank was designed to ensure that Nigerians get the right quality and quantity of goods we buy from abroad and at the right prices. All these measures can directly or indirectly bring about economic and financial stability.

3.6 The Role of the Central Bank in Foreign Exchange Control

Federal ministry of finance is the government authority charged with the responsibility for the basic exchange policy and the minister of finance bears the cabinet responsibility for all that goes on in the exchange control department. It is however the central Bank that deals with the day- to – day administration of exchange control department. Such things as approval of application for copy rights, payments of shipping and marine insurance dues, repatriatation of capital, transfer of profits to foreign countries by foreign companies, raising of external loans ,their repayments, borrowing in Nigerian by companies which are directly or indirectly controlled from abroad, granting of "approved status" to non – resident investment in Nigeria and any dealing with foreign securities are taken care of by the ministry. Any other remittances, and there are a great deal of them, are the business of the central Bank. For the purpose of such remittance the central bank authorities engaged some reputable banks to handle. Union bank and first bank handled considerable amount of these transactions.

Central Bank carries out regular allocation , usually determined within the frame work of foreign exchange to all the dealers. This allocation is usually determined within the frame work of foreign exchange budget drawn up at the beginning of every financial year. In the words of Mr. Ola .O. Vincent, then Governor of the central bank, "the central bank undertake detailed studies of international monetary developments for policy guidelines, and in order to operate within the frame work of international monetary and financial changes.' Some other functions of the central Bank in the external sector include maintaining financial monetary relations with external monetary institutions like international monetary fund, (IMF) Association of African central Bank (AACB) our own central bank is a foundation member and it also spear headed the formation of the West African clearing house which is based in Freetown, Sierra Leone. This financial institution was established with the aim of facilitating trade expansion among ECOWAS countries. Infact a staff of the central bank of Nigeria represents the country as alternate director on the board of the ECOWAS Fund for co-operation, compensation and Development. Nigeria's central Bank activity participates in international conference relating to financial and economic developments. (IMF,2004)

The central Bank does not do commercial banking as the commercial and other banks do. It aids indirectly the development of the country and it serves as the federal government's banker and it therefore renders banking service to federal government just as the commercial banks to their customers. Apart from these functions any other functions is aimed at ensuring that the country is economically and financially stable. That is, inflation is as much as possible guarded against.

3.7 The Central Bank in the Realm of Economic Development

There are four areas in which the central bank has continued to endeavour to assist economic development of this country. The areas are agriculture,(CBN, 2015) money and capital market, research and manpower development of staff of commercial and merchant banks .Its contribution to the development of agriculture and Export trade can not be over emphasized, because of the close relationship they bear with financial and economic stability of any country. Central Bank excises control on the distribution of credit by commercial banks for the purpose of ensuring, among another things that a large

proportion of their loans go to agriculture. As a rule commercial banks heed this directive and where there is a shortfall, such shortfalls are to be deposited with the Central Bank which will eventually lend it to the Nigerian Agricultural and co-operative Bank.
This emphasis on agriculture cannot be a misplaced one as agriculture is supposed to be the mainstay of any country's economy. (Ocheja, 1983) For instance, we have failed to develop our agricultural economy and as a result we resorted to large scale importation of food items such as rice, wheat and many canned foods, including meat.(Ocheja,1982) Consequently our foreign reserve dwindled very drastically, more so as the time of large scale importation of food items coincided with the period of oil glut. Nobody who is knowledgeable in Economics will consider that all is well with our economy when our balance of payment is in a precarious position. What we have so far witness is nothing short of economic and financial instability. Some of the way through which the Central Bank has concretely aided the development of agriculture are expansion of banking facilities to the rural areas where the majority of farmers live. Through its Rural Banking Programme introduced in 1977 commercial banks were given a target figure of 198 new branches of banks in the rural areas between 1977 and 1980. Each commercial bank was assigned a specified geographical area to cover. Another scheme for similar purpose is the Agricultural credit Guarantee scheme fund established under Decree No. 20 of 1977. N50,000 was the maximum loan that can be guaranteed in respect of a single farmer and for farmers' co-operatives N1.0 million is the maximum. (Enemona, 1993). By 1978 a total of 782 loans to farmers had been guaranteed. To ensure smooth functioning of the scheme, Federal Government set up Agricultural Finance Department to oversee and to advise the farmer whose loans for agriculture have been guaranteed. Central Bank has for a quite long time been responsible for providing loans for the purchase and sale of agricultural produce by Nigerian Commodity Board and the dissolved Nigerian produce Marketing Company. If a country experience deficit in her balance of payment as regards foreign trade the simple interpretation is that it imports more than it exports. Apart from the fact that Nigerians are naturally lovers of foreign made goods, it must be frankly stated that we have nothing of economic significance, apart from our crude oil, to export. We have failed to develop those sectors of the economy that will boost export-oriented trade. Here again, the central bank has stepped in to arrest that state of affair where our imports have always been grossly at variance with our imports. The bank through the Nigerian Export Promotion Council (NEPC) strived vigorously to encourage the development of export trade in the country. Although the council was short-lived its advice and suggestions have left their marks on the thinking of some of our business men and women. The council's responsibilities include among other efforts, to spearhead the national effort in the export development and promotion by operating ideas, suggestion and measures designed to advance the course of the Nigeria's export trade; to advice and assist government in the identification of export – oriented industries and to help to stimulate the growth of non – traditional exports from Nigeria; and to assist the government in the creation of necessary export infrastructures such as export financing services and other export trade promotional activities.

4.0 CONCLUSION AND RECOMMENDATIONS

4.1 Conclusion

All the regulatory controls of the central bank are designed to ensure that the economy is at all times free from inflation. The controls are exercised through some devices such as open market operation, rediscount and discount rate policy, moral suasion, cash reserve requirement, special deposits, stabilization securities, liquidity ratio, selective credit control, direct regulation of interest rates and call money scheme. Embedded also in its traditional roles of issuing the currency, serving as banker and financial economic adviser to the federal government, promoting monetary stability and a sound financial structure and maintaining foreign reserve to safeguard the value of the naira, are certain power of control which are not apparent but are equally effective. These powers can also be found in the bank's effort to aid development of the economy.

Indeed, the central bank plays paternalistic roles and over the years these roles have become effective and indispensible

4.2 Recommendations.

The central bank of Nigeria should strengthen its control in the area of establishment of Banks, because the frequency of failed banks and banks folding up is very embarrassing. Creation of higher denominations of the Naira such as 2000 and 5000 Naira notes by the Central Bank should not be carried out in the near future because of its effects on inflation

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