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Research Paper

ECONOMIC DEREGULATION AND THE NIGERIAN BANKING INDUSTRY: A REVIEW

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ABSTRACT

Nigeria witnessed a serious economic and financial crisis in the early 1980's which was a fall out of mismanagement and global shocks. Therefore it was apparent that substantial economic reforms must take place in order to correct the prevailing macroeconomic and structural imbalances. This paper attempts to review some of the economic policies that characterized the era. The study appraised the effects of economic deregulation on the development of the banking industry in Nigeria as against the excessive regulation that characterized the industry prior to 1986. It determined the extent to which economic deregulation had influenced deposit mobilization by banks in Nigeria. It also determined the rate of growth of banks in the banking industry during the deregulation era. In carrying out the study, Averages was used to check the possible economic effects of the following economic indicators Bank Growth Rate (GR) , Interest Rate (R), Exchange Rate (ER), Bank Credits (BC), Deposit Liabilities (DL) and Inflation Rate (IR) on the economy during regulation and deregulation period in Nigeria from 1970 – 1985 and 1986 – 2001. The results of our findings show a higher bank growth Rate during the regulation period than the deregulation period. Interest Rate was lower during the regulation period than the deregulation era. Exchange Rate of the naira was also observed to be lower during the regulation period than the deregulation period. For Deposit liabilities, the trend changed, as there were more deposit liabilities during the deregulation period than the regulation period. Inflation Rate was higher during deregulation period than regulation period. Bank Credits was observed to be higher during deregulation period than regulation period. Finally, our five recommendations were made based on our findings.

KEYWORDS: *deregulation, Interest Rate , Exchange Rate , Bank Credits , Deposit Liabilities and Inflation Rate*

1.INTRODUCTION

Every country desires to enhance its economic growth so as to improve the standard of living of its populace. In reality, growth process does not follow a definite pattern. Whereas some might emphasize taxation as a trajectory, others may emphasize surpluses of public enterprises, borrowing, trading, and export of minerals etc (Anochiwa and Maduka, 2015). For a developing country like Nigeria, where most of its financial institutions are not finally matured, government regulates some financial activities. At other times, government might decide to play a passive role, in the management and administration of the banks or the financial sector as a whole. When this happens, we say there is a deregulation of the financial sector.

The banking institutions are crucial to any government, and play key role in the development of the economy (Todaro and Smith, 2011). The effectiveness and efficiency of performing these roles depends largely on its development and management, thus the need for reforms. Almost two decades after independence in 1960, Nigeria enjoyed fairly a stable economic growth to the extent that it was an era referred to as oil-boom. The country became a victim to ostentatious way of life, such that by early eighties when their was a global oil glut, her revenue earning was adversely affected and she became vulnerable to debt crises and macroeconomic disequilibrium. From that time, Nigeria began to tinker with an economic reform programme as a pre-condition for not only rescheduling its $30 billion external debt, but the management of the Naira. Subsequently, structural adjustment programme (SAP) was introduced, mainly due to the persistent and destabilizing economic crises that followed. Some macroeconomic indicators explain the pressure the country was passing through then- balance of payment problem, debt service burden, rising unemployment and foreign exchange crises etc. It will be recalled that the financial sector applied diverse monetary control instrument to manage the economy. At the end, it appears that the Central Bank of Nigeria (CBN) and others banks were not coordinating their activities in the overall interest of the economy. The existing structures were ineffective making the demand for reform (deregulation) imperative.

While reporting on the works of various authors on financial intermediation, Ndebbio (2004), posited that the economic development of any nation greatly depends on financial intermediation banks' play in facilitating technological innovation through their intermediation roles, just as he observed that stagnant growth in output of any country, especially the less developed ones, is often blamed on shallow finance. However, Mckinnon (1973) and Shaw (1973), in a financial repression hypothesis, argue that the performance of banks in the growth process is affected by the regulation of the system. Akpan (2004) and other proponents of financial regression believes in the financial market driven by the forces of demand and supply hence with trend interest rate, depositors earn greater interest on their deposits and are encouraged to deposit. While we may consider this paper as a review, no doubt the differences between those who favour deregulation and those who disfavor it have not been settled empirically. It is on the basis of this divergence of opinion that we examine and appraise the impact of deregulation in the banking sector to the economy.

The paper focuses on effects of economic deregulation on the banking industry. Section two is on conceptual framework and literature review while section three is on research methodology and model specification section four is on findings and discussion. Section fine, concludes and recommends and recommends.

2.1 CONCEPTUAL FRAMEWORK

Regulation by simple definition means government control of the major aspects of the structure and economic performance of the banking industry. The Nigerian banking sector is primarily regulated by two bodies. The CBN and the Nigerian Deposit insurance company (NDIC). Their bodies are set up by law to control and regulate financial activities and monitor actors within the Nigerian banking system. Bank deregulation therefore refers to the elimination (whether partial or total) of certain laws that apply to the banks. It usually happens at the national in the industry the leaurage to be more self-regulatory.

Banking reforms is the changing of banking system architecture, technological innovation, and fire-tanning the rules guiding the practice of banking in many jurisdictions (Okagbue and Aliko, 2004). Bank reforms are predicated upon the need for reorientation and reposition of existing status quo in order to attain an effective and efficient state, and fast track and consolidate specified sector of the economy to achieve desired objectives (Alo, 2010 and CBN 2011).

Nigeria introduced a full blown deregulation of the banking sector at the beginning of 1986. This reform was a fall out of the structural adjustment programme (SAP) regrettably; SAP is guilty of certain unrealistic assumptions. For example, SAP came with the introduction of the foreign exchange market (FEM). The policy was introduced to allow the market forces to determine the exchange rate of the naira against other currencies of international trade. It was said that the naira was overvalued and discouraged in flow of foreign capital especially foreign direct investment (FDI).

2.2 LITERATURE REVIEW

As noted earlier, the origin of deregulation in Nigeria is imbedded in mending domestic imbalances and macroeconomic disequilibrium in the early 1980s which led to economic distortions and slowed growth (Maduka *et al.,* 2015). The theoretical foundation of deregulation is largely taken from the general equilibrium theory, which postulates the relevance of the society's limited resources for efficient production of the needs of the society and efficient distribution of commodities and services among various consumers. The rational for the deregulation of the banking industry is anchored on the idea to revitalize the Nigerian economy so as to strengthen the naira and make the value more realistic and exports more competitive. Operators of the Nigerian economy where advised by the international monetary fund (IMF) to allow "market forces" determine the true value of the naira (Maduka, *et al.,* 2015).

Deregulation is often accompanied by increased market competition. It compels banks to compete with one another for core deposits; their level of exposure to risk may increase as the spread between the cost of funds and the return of funds narrows (Sundarajan, 1991). They have also identified several ways by which financial reform could increase uncertainties of both the financial and iron financial sector which includes relaxed freedom to entry into the financial sector and freedom to bid for funds through interest rates and new investment, which could lead to excessive risk-taking. It could also lead to:

- Excessive reliance on economic rather than prudential regulations, which should focus on bank solvency and credit risk.
- Mismatch of investments; the deregulation of interest rate could affect financial institutions that have large exposure to long-term assets funded by short-term liabilities, which carry fixed interest rates.
- Inadequacy of instrument of monetary control or insensitivity to the need for the control of interest rate during deregulation.

According Ojo (2010), financial repression gives rise to inadequate amount of mobilized savings which has to be rationed in an inefficient manner to a small group of favoured borrowers. Interventions by the authorities in the money and capital markets have the effects of distorting the flow of credits as well as indirectly sustaining the apparent excessive risk aversion of financial intermediaries in developing countries. Schumpeter (1934) has early postulated that banks play important role in economic development. He said, "The services provided by financial intermediaries mobilizing savings, evaluating projects, managing risks, monitoring managers, facilitating transactions are essential for technological innovations and economic development".

In view of the important role financial institutions plays in a period of reform and deregulation, the structural adjustment programme was conceived to achieve fiscal balance of payments viability, adoption f a realistic exchange rate policy through the establishment of a second tier foreign exchange market (SFEM), reduction of complex administrative controls and fostering reliance on market forces, deregulations, rationalization, commercialization and privatization of the public sector enterprises etc (Okongwu C.S.P. 1987).

De Gregorio and Gidohi (1995), Lavine and Zervos (1996) have established that banking sector's development is correlated with economic growth and also a source for long term growth. Several empirical studies have been conducted on consolidation, recapitalization and banking sector reforms in Nigeria, such as Nnana, 2005; Balogun, 2007. They lend credence to the impact of reforms in the banking sector on economic growth.

Although, some proponents of the deregulation of the economy argue that the reform have brought about real and relatively greater improvements with regard to deficits, inflation rates and foreign trade, others are quick to castigate it for having woefully failed to redress the basic structural deformities of the Nigerian economy and in particular it brought about devaluation of the currency that raised the cost of service external debts and led to deflationary policies that depressed economic activity.

3.1 METHOD OF DATA ANALYSIS

As stated in session One, in every research work various methods or techniques are usually open for the collection and analysis of the necessary data to provide some solutions to the identified problems. Specifically, the nature of a study determines the method of approach to be adopted in eliciting the relevant information so required. The following methods were used in this study.

(a)Data Collection Technique:

The technique of Data Collection was mainly through library research and review of related literature on published documents from CBN and FOS.

(b) Techniques of Data Analysis:

The study employed the use of averages to make comparison of both regulation and deregulation periods. As already highlighted, the main focus of the analysis was on the effect of economic deregulation on the Nigerian Banking Industry. Hence, the research analyzed the development in the banking industry before deregulation (1970 - 1985) and during deregulation (1986 - 2001). And combinations of both eras to further see the effects on the economy.

The research analyzed the performance of commercial Banks (growth rate) in the banking industry between 1970 - 1985; 1986 - 2001; 1970 - 2001) using the same sample size for both regulation and deregulation era. This is to enable the researcher have a reasonable comparison of the averages and find out the effect of economic deregulation on the banking industry. Another reason for using equal sample size of pre-deregulation and deregulation era is that during deregulation period of 1986 - 2001, the Nigerian economy was not completely deregulated as there were elements of regulatory policies in the various sectors of the economy, particularly more in the banking industry. However, the economy of Nigeria has always been regulated even during the deregulation era.

4.0 PRESENTATION AND ANALYSIS OF DATA

This session is therefore devoted to the presentation and analysis of research data. The data used in this study are secondary from C.B.N. Statistical Bulletin and Federal Office of Statistics. The session is divided into two parts: Viz, data analysis and computation of averages. The former is based on the Research questions and computed averages. In this session we present the test of the validity of the hypothesis formulated in session One. The statistical technique used in testing the hypothesis is the computation of statistical averages for period of regulation and deregulation..

4.1 Data Presentation

The data used in this study are average annual values on commercial Banks growth rate (GR), Interest rate (R), Exchange rate (ER), Bank credits (BC), Deposit Liabilities (DL) and Inflation rate (IR). The data covers the period of 32 years - 1970 - 2001.

Table 4. 1 Regulation and deregulation period (1970 – 2001)

Year	Growth Rate R	Interest Rate (R)	Exchange Rate (ER)	Bank Credits (BC)	Deposit Liabilities (DL)	Inflation Rate (IR)
1970	13.8	7.00	0.7143	351.4	624.8	13.8
1971	16.5	7.00	0.6955	502.0	657.1	16.0
1972	15.4	7.00	0.6579	619.5	793.7	3.2
1973	4.9	7.00	0.6579	735.5	1,013.0	5.4
1974	4.7	7.00	0.6299	938.1	1,693.9	13.4
1975	8.2	6.00	0.6159	1537.3	2839.2	33.9
1976	6.2	6.00	0.6265	2122.6	4164.4	21.2
1977	6.3	6.00	0.6466	3074.7	5235.2	15.4
1978	24.8	7.00	0.6060	4109.8	5302.6	16.6
1979	9.4	7.50	0.5957	4618.7	6967.8	11.8
1980	10.1	7.50	0.5464	6379.2	10009.1	9.9
1981	17.4	7.75	0.6100	8604.8	10676.9	20.9
1982	14.0	10.25	0.6729	10277.0	12018.9	7.7
1983	11.8	10.00	0.7241	11100.0	13938.5	23.2
1984	12.7	12.50	0.7649	11503.4	15734.8	39.6
1985	3.8	9.25	0.8938	12170.3	17597.1	5.5
1986	5.4	10.50	2.0206	15701.5	18137.6	5.4
1987	8.5	17.50	4.0179	17531.9	23086.7	10.2
1988	12.3	16.50	4.5367	20044.9	29065.1	38.3
1989	11.4	26.80	7.3916	22221.2	27164.9	40.9
1990	4.5	25.50	8.0378	26083.9	38777.3	7.5
1991	4.3	20.01	9.9095	31762.4	53208.7	13.0
1992	0.5	29.80	17.2984	41810.0	75047.7	44.5
1993	0.8	36.09	22.0511	48056.0	110453.6	57.2
1994	0.4	21.00	21.8861	92624.0	142537.5	57.0
1995	3.4	20.18	21.8861	141146.0	178962.1	72.8
1996	1.7	20.13	21.8861	169242.0	214359.8	63.0
1997	0	13.54	21.8861	230,600.0	274,521.0	8.5
1998	-9.2	18.29	21.8861	272,895.5	304,888.8	10.0
1999	0	21.32	-	353,081.1	441,283.0	6.6
2000	0.4	17.98	-	508,302.2	664,031.6	6.9
2001	0	18.29	-	796,164.8	928,327.0	18.9

Sources: *CBN Statistical Bulletin Vol. 8, No. 2, Dec. 1997 and Federal Office of Statistics*

Note: That the official Exchange Rate terminated in December, 1998

From the above discussions the averages of the economic indicators are computed for pre-deregulation period (1970 – 1985) and deregulation period (1986 – 2001)

Where GR = Bank Growth Rate; R = Interest Rate; ER = Exchange Rate; BC = Bank Credit; DL = Deposit Liabilities; IR = Inflation Rate

Averages = $\sum X \leq \sum F$

Where = $\sum X$ is the sum of observation

$\sum F$ is the sum of frequency

FOR BANK GROWTH RATE (GR)

Regulation Period (1970 – 1985)

$\sum X = 180$

$\sum F = 16$

Average = 180/16 =11.3

Deregulation Period (1986 – 2001)

Average = 44.4/16 = 2.8

FOR INTEREST RATE (R)

Regulation Period (1970 – 1985)

Average = 124.8/16 =7.79

Deregulation Period (1986 – 2001)

Average = 333.04/16 = 20.815

FOR EXCHANGE RATE (ER)

Regulation Period (1970 – 1985)

Average = 10.658/16 =0.666

Deregulation Period (1986 – 1998)

Average = 184.6941/16 = 11.54

FOR DEPOSIT LIABILITIES (DL)

Regulation Period (1970 – 1985)

Average = 109,267.0/16 = 6,829.187

Deregulation Period (1986 – 2001)

Average = 3,523,852.4/16 = 220,240.775

FOR INFLATION RATE (IR)

Regulation Period (1970 – 1985)

Average = 257.5/16 = 16.09

Deregulation Period (1986 – 2001)

Average = 427/16 = 26.69

FOR BANK CREDIT (BC)

Regulation Period (1970 – 1985)

Average = 78,644.3/16 = 4,915.26

Deregulation Period (1986 – 2001)

Average = 2,787,267.4/16 = 174,204.21

Table: 4.2 Tabulation of averages for regulation and deregulation period.

ECONOMIC INDICATORS	REGULATION PERIOD (1970-1985)	DEREGULATION PERIOD (1986-2001)
BANK GROWTH (GR)	11.3	2.8
INTEREST RATE (R)	7.8	20.8
EXCHANGE RATE (ER)	0.6	11.5
DEPOSIT LIABILITIES (DL)	6,829.2	220,240.8
INFLATION RATE (IR)	16.1	26.7
BANK CREDIT (BC)	4,915.26	174,204.21

4.2 Hypothesis testing

The overall significance of each of the economic indicator is carried by comparing the averages of the two periods (Regulation and Deregulation)

4.3 HYPOTHESIS

H_O: $b_i = 0$ -There is no significant change in Bank Growth rate (GR), Interest rate (R), Exchange rate (ER), Bank Credits (BC), Deposit Liabilities (DL), and Inflation rate (IR) during deregulation in the banking industry.

H_A: bi $\neq 0$ - There is a significant change in GR, R, ER, BC, DL and IR during deregulation in the banking industry

From the results of the computation and the tabulation above only DL and BC showed positive changes during deregulation period. The others (for GR, R, ER, and IR) had negative effect on the banking industry during deregulation than regulation period. This implies that the null hypothesis (H_O: $b_i = 0$) is rejected for the positive changes observed in DL and BC, during deregulation but accepted for the negative changes in GR, R, ER and IR after deregulation in the banking industry. That is there is a significant change in GR, R, ER, and IR as suggested by the results. The computation is significant in explaining Bank growth rate in the Banking industry in Nigeria during deregulation

5.0 SUMMARY AND CONCLUSION

After evaluating the effect of economic deregulation policies from different views, we conclude that economic deregulation is an essential tool to achieving a sustainable economic growth in the banking Industry and the economy as a whole. For deregulation policies to work effectively or achieve the desired goals, it does not depend only depend on the effectiveness of the Macro-economic policies, but other factors such as, good banking environment that is fraud free, good leadership, honesty among banks officials and discipline. This work suggests that economic deregulation policies are workable in Nigeria as the banking industry witnessed impressive growth under it. The policies may not have been well implemented and is undermined by several factors, some of the factors include:

i. Excessive violation of interest rate and Exchange rate policy, which result in instability in the economy.
ii. The incidence of bad debt and bank fraud that has been the major problem for distress in the banking industry
iii. The problem of Turmoil in the financial system, which is often caused when the C.B.N. feels, compelled to take fire-fighting measures to handle the liquidity situation.
iv Poor implementation of deregulation policy.
v. Inflationary pressure on the economy that affects Interest rate.

With regards to the above-identified problems in the Nigerian banking Industry, from the research findings, the following recommendations were made.

5.1 Recommendation

1. Economic deregulation policies should be continued and well implemented by the various government authorities concerned.
2. Fraud in the banking industry should be effectively checked to avoid further distress of some banks in the industry.
3. The problem of turmoil in the financial system, which is caused by C.B.N., should be checked so that banks will not suffer such severe liquidity mop-up measures as a result of inflation rate.
4. The violation of Exchange and interest rate policy should be checked so as to realize the desired effect of economic deregulation in the banking industry.
5. The Management of inflation rate should be the joint task of banks and government. Fiscal discipline must be institutionalized to ensure effective control of public debt and deficit financing so as to manage inflation in the economy and achieve the desired benefits and effect of economic deregulation on the Nigerian banking industry.

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