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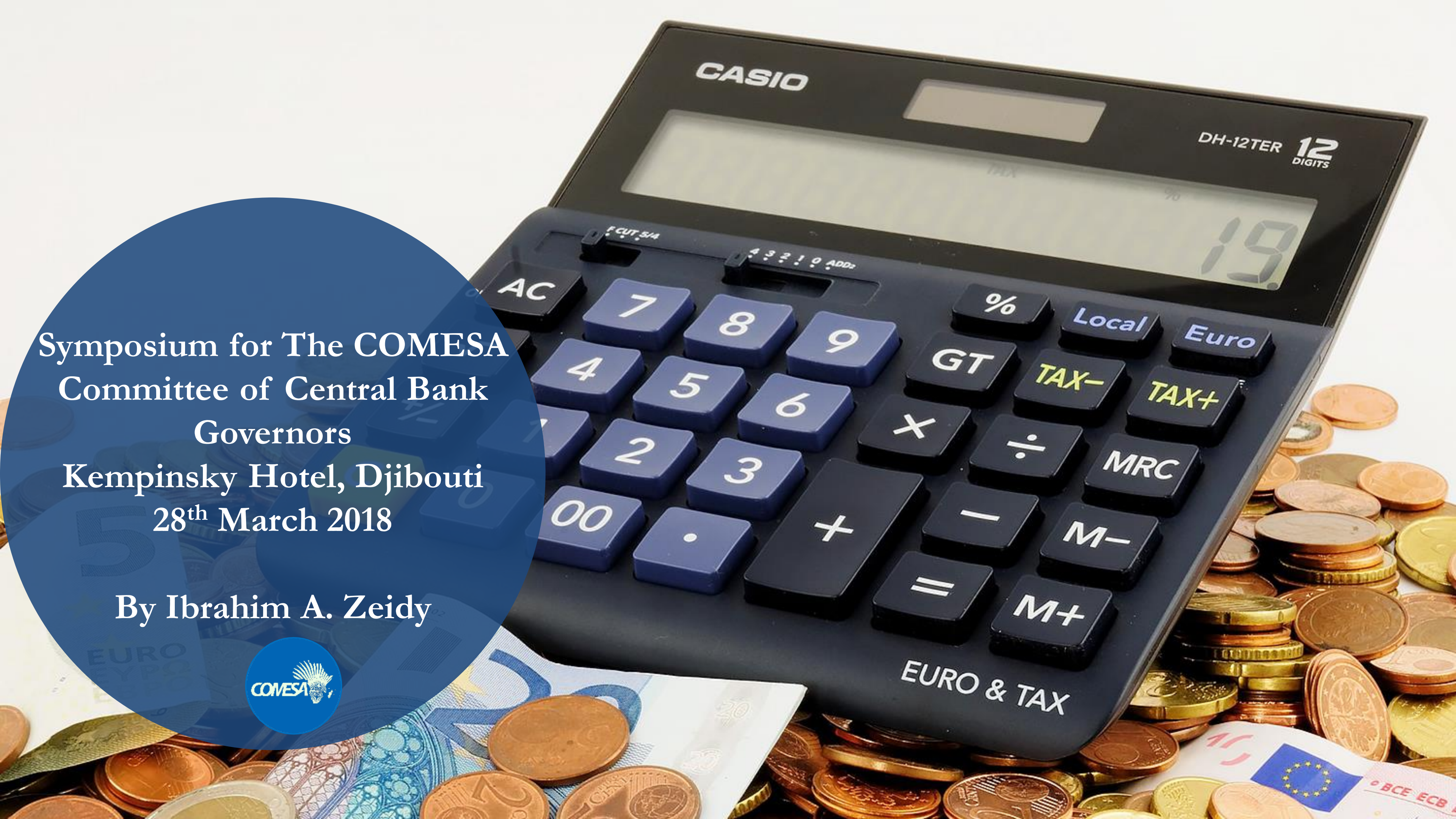

Role of Central Banks in Supporting Economic Growth-the Case of Central Bank of Nigeria and the State Bank of Pakistan

Outline

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Experience of central Bank of Nigeria and State Bank of Pakistan in Financing Economic Growth and Development and Challenges

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Introduction

- The 'best practice" of Central banking prescribed by the international financial institutions such as IMF as well as by many prominent economists is "Neo-liberal approach to Central Banking"
- The main components of this recipe are:
  i. Central Bank Independence;
  ii. Focus in controlling inflation;
  iii. Use of Indirect methods of monetary policy
- It is a documented fact that macroeconomic stability, and healthy, sound, efficient and stable financial systems are necessary conditions and key factors for sustained economic growth.
- However, Implementation of the policy of targeting inflation proved to be difficult in many developing countries, in the context of supply shocks, where the main problem facing less developed countries is too little supply, not too much demand. Some developing countries are therefore, besides discharging their traditional functions of regulating money and credit are trying to bring sustainable economic growth into the agenda by implementing policies, schemed, programmes and innovations for the provision of development finance.
- The financial crisis of 2008 has also broadened the role of Central Banks beyond ensuring price stability. Central Banks in Developed and emerging countries introduced unconventional monetary policies in the wake of the crisis. The policies include: provision of extraordinary liquidity to banks; and outright bond purchases to ease financing conditions Among others.
- The objective of this paper is to present a case study of the experiences of Central Bank of Nigeria and State Bank of Pakistan which are applying alternative approached to promote sustainable development while also adhering to inflation Control.

Experience of central Bank of Nigeria in Financing Economic Growth and Development and Challenges

- The paper is organized as follows: Section 1 presents case studies of Central Bank of Nigeria and State Bank of Pakistan which are currently implementing central bank interventions to promote economic growth while also focusing on inflation control. Challenges which are faced by the two central banks in provision of development finance will also be discussed in the same section. The final section highlights key lessons to be learned from the case studies.
- The central Bank of Nigeria's development finance role initiatives involve the participation of Central Bank of Nigeria directly or indirectly in developmental activities in terms of the formulation and implementation of various policies, schemes, programmes and directives for the provision of sufficient or adequate finance and credit to the productive sector.
- Section 31 of the Central Bank of Nigeria Act empowers it to subscribe to any government corporation for promoting financial or economic development.
- CBN reforms since 2009 have been to ensure that banks play their role of financial intermediation to drive sustainable growth by firstly ensuring financial stability t and secondly, to ensure that banks provide funding to the productive sector of the economy
- The Central Bank of Nigeria conducted development finance roles through its credit schemes such as:
    1. Refinancing facilities for Agricultural export commodities.
    2. Rural Finance and banking support scheme
    3. Agricultural credit Guarantee Scheme
    4. Small and Medium Enterprise Equity Investment Scheme
    5. Commercial Agricultural Credit scheme
    6. Small and Medium scale industry credit scheme

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1. Refinancing Facilities for agricultural export commodities. This scheme had made significant contributions in Nigerian economy by increasing inflow of credits to the farmers producing export commodities in Nigeria. This helped to increase foreign exchange earnings , foreign direct investment, and thus facilitated economic growth.

2. Rural Banking and Finance Programme. This is designed to increase access of the rural dwellers to financial and credit services aimed at promoting the financing of agriculture., small scale industrial activities. This credit scheme has improved the life, economy and development of rural areas, though not all the Nigerian local governments benefited from the system. This is expected to assist in achieving integrated rural development in rural areas and facilitate economic growth and development of the Nigerian economy.

3. Agricultural Credit Guarantee Scheme. The scheme guarantees 75% of any default This is designed to revamp and boost agricultural sector through the provision of loans to small and medium farmers of Nigeria. This credit scheme has increased the inflow of credit to the Nigerian farmers, increased the acquisition and adaptation of new improved quality seeds, fertilizers, pesticides and machines among the beneficiaries' farmers. As a result this increased the farmers output, income, employment generation and standard of living.

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4. Small and Medium Enterprise Equity Investment Scheme

This was initiated by the Bankers' Committee and was operational from 2001-2007. The scheme is designed to provide finance and credit to small and medium enterprises in Nigeria to enhance ownership of business. This expected to help the Nigerian Economy to develop local technology, generate employment, encourage investment and productivity and of course economic growth

5. Commercial Agricultural Credit Scheme.: Central Bank of Nigeria designed this scheme in order to fast track the development of the agricultural value sector of the economy through provision of credit facility at single digit interest rate to large scale commercial farmers. The scheme has improved the commercial and large scale agricultural production in Nigeria. This also enhances the Nigerian Export commodities and increase foreign exchange earnings etc.

6. Small and Medium Scale Industry Credit Scheme.

This scheme is designed to accelerate the provision and supply of finance and credit to Nigerian industries and manufacturing sector. Sustained and sufficient provision of finance and credit to these sectors are expected to help the Nigerian economy to accelerate and achieve industrialization, advancing manufacturing sector, advance technology, machines, mass production and exports.

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7. Schemes for Medium and Small Enterprising Financing. CBN launched the Microfinance Policy, Regulatory and Supervisory Framework in 2005

8. Specialsed Development Finance Institutions

The Central Bank of Nigeria provides equity to the following institutions:

1. Nigerian Agricultural Cooperatives and Rural Development Bank
2. Bank of Industry
3. Nigerian Agricultural Insurance Corporation
4. Federal Mortgage Bank of Nigeria
5. Nigerian Export and Import Bank.

Challenges

The Central Bank of Nigeria's credit scheme faced with the following challenges:

1. High incidence of loan diversion among beneficiaries
2. High interest rate charge by some banks against Central Bank of Nigeria Directive and the small size of the loans to some beneficiaries
3. Most of the credit schemes lack effective mechanism for monitoring the operation and the performance of the scheme;
4. Lack of clear written rules and regulations that will guide the activities of the credit scheme,
5. Lack of adequate information and publicity to creditors.

The Experience of State Bank of Pakistan in Supporting Economic Growth and Challenges

1. From 1960s to the 1980s, the State Bank of Pakistan (SBP) promoted long term finance through the development finance institutions (DFIs). During this period, it also devised instruments for the provision of credit to priority sectors, mainly agriculture, key industries, exports and housing.
2. Since liberalization in the 1990s the DFI have been gradually phased out and priority sector lending has also reduced considerably.
3. The Bank over the years has introduced special schemes under its refinance window to ensure adequate supply of financing to the value added industries at competitive rates for enhancing their production capacity and meeting working capital requirements These schemes mainly include: Export Finance scheme; to ensure short term credit availability for exporters and long term financing facility for encouraging export led growth on the long term basis. In addition to promoting exports of the country, SBP has also introduced some special medium to long term refinance facilities at subsidized rates for other sectors such as schemes on renewable energy, warehouses and cold storages for storing agricultural produce and purchase of machinery for SMEs. These schemes are regularly reviewed to effectively achieve the desired objectives.
4. The Bank also developed a credit guarantee scheme, funded by the Federal Government, for small and marginalized farmers which would facilitate flow of credit to small and marginalized farmers who do not have any collateral. The objective of the guarantee scheme is to encourage financial institutions to lend to small farmers

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The Bank in Supporting Economic Growth uses the following institutional mechanisms to perform its functions :

1. Private Sector Credit Advisory Board(PSCAC): The main objective of PSCAC is to suggest ways and means to widen the private sector’ s access to credit with a view to promote economic development.
2. Agricultural Credit Advisory Committee(ACAC) is a national level consultative Committee for setting annual targets for agricultural loans and its monitoring. ACAC performs the following activities;
   - Assess agricultural loan requirements in the country;
   - Give annual agricultural loan targets to individual banks;
   - Review the achievement of Bank against the Annual agricultural loan targets
   - Improve the supply and recovery of agricultural loans; and
   - Suggest actions for increasing banks’ capacity and introduce new agricultural lending products.
   - The Committee is Chaired by Governor of SBP and has membership from federal/Provincial governments, Banks, and Chambers of Agriculture/ Farmers’ Association.

Impact of institutional credit on growth of priority sectors

1. Impact on Agricultural Sector

- In 2012-13, some 27 commercial banks, Islamic and microfinance institutions with around 3900 agriculture designated branches were extending agricultural credit throughout the economy.
- Empirical evidence found a positive impact of institutional or formal credit on agricultural GDP, which showed that bank lending was an important factor in the growth of agriculture (M.Iqbal, Ahmad, Abbas and Mustafa, 2003)

2. Impact on Industry and exports

- Manufacturing sector receives the largest chunk of institutional credit. Yet growth in that sector has been slack for the following reasons:
  - A large chunk of the lending was going into working capital loans rather than long-term project financing
  - Concentration of bank credit in textile(the largest manufacturing sector) to the exclusion of industries that may exhibit higher productivity.
  - Since the demise of DFIs and concentration of credit disbursement through commercial banks, financing for long gestation projects has considerably reduced,
  - the demise of DFIs also meant that the capacity for project appraisal for new industries has declined.

3. Impact on Exports

- Both growth in exports and its product mix have remained virtually stagnant for a number of years. it I was difficult to assess if Export Finance Scheme(EFS) has been successful or not, since a number of other factors determine a country's export trajectory.

Challenges

The following are challenges faced by State Bank of Pakistan

- A large chunk of lending to manufacturing goes into working capital loans rather than long-term project financing
- Concentration of bank credit in textile (the largest manufacturing sector) to the exclusion of industries that may exhibit higher productivity.
- Since the demise of DFIs and concentration of credit disbursement through commercial banks, financing for long gestation projects has considerably reduced,
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Lessons to be Learned

The analysis in the preceding sections demonstrate the developmental roles of central Bank of Nigeria and State Bank of Pakistan which includes, ensuring credit to productive sectors of the economy and expanding access to affordable financial services in addition to their traditional roles of ensuring macro-economic and financial stability. However, it was not easy to fully achieve their objectives. The following are some of the lessons which can be leaned from the experience of the developmental role of the two central banks:

- Central Banks in our member Countries should continue their traditional role of maintaining macroeconomic stability.
- They should ensure that financial institutions play their role of financial intermediation to drive sustainable growth
- They should ensure the diversification of financial instruments and institutions. Monetary Policy will be more effective in countries with deeper financial markets and diversified financial instruments.
- Ensure financial stability.
- Strengthening of regulatory and supervisory functions of Central banks.
- Ensure that fiscal deficits will not crowed out credit to the productive sector.
- Need to ensure that lending rates are not so high and stifle productive activities

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If a Central bank has special developmental schemes in addition to its traditional roles there is need to ensure the following:

- All tiers of Government give the necessary support, adequate attention and publicity to the Central Bank initiative in order to sustain its development finance practices;
- There is effective monitoring mechanism and clear written rules and regulations that will guide and monitor the operations and performance of the development finance initiatives of the Central bank in order to prevent failure
- Central bank could provide strong and sustainable incentives to financial institutions in order to encourage the supply of adequate, just, easy and favorable credit to the productive sector. One incentive which is proposed by some economists is allowing formal financial institutions to hold smaller required reserves on assets that are identified as contributing to employment generation and poverty reduction.
- Need to ensure that direct lending through developmental activities of the central bank to the priority sectors do not create moral hazard and inefficiency in the financial system.

Questions & Answers

THANK YOU