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Effects of Fiscal and Monetary Policies on the Nigerian Manufacturering Sector

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Abstract

This paper investigates the effect of monetary policies on the Nigerian manufacturing sector. The paper used anecdotal evidence to x-ray the suits of monetary policies initiated in order to promote a vibrant manufacturing sector in Nigeria. The evidence suggests that manufacturers in Nigeria are not maximizing the benefits of these policies. The paper therefore, identified opportunities the current Central Bank of Nigeria exchange rate policy provided for manufacturers, in terms of skill and technology transfer, patent rights and the domestication of foreign technology. The paper also charged the government to decentralize power generation. That is, legally empowering manufacturers to generate their electricity through micro-grids.

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1 Introduction

Before the 1930s great depression, the economy was governed by the general

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theories that perceive the market as sacrosanct and that supply creates its own demand. The market was also seen as efficient and effective in equitable allocating resources and economic managers were encouraged to allow the forces of demand and supply dictate the direction of the economy. The prolonged economic depression radicalized the economic and political thinking. This was influenced by Keynes [1], who advocated for government intervention in economic management. The effectiveness of government intervention in stimulating economic recovery after the 1930s depression essentially brought to the fore, the important role of government in economic management, a practice that has gained global acceptability till date.

Policy options commonly employed by the government are fiscal and monetary policies. Fiscal policy is the use of government revenue (taxation) and spending (expenditure) to achieve macroeconomic stability. Fiscal policy channels are tax rates, interest rates and government spending [2]. Monetary policy on the other hand is the process (or a set of measures) through which the monetary authority controls the supply (or cost) of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the economy. The general goals of monetary and fiscal policies are to promote sustainable economic growth and stability, low unemployment, viable external balance position, price stability, and favourable macroeconomic environment that stimulate investment and production [10].

The use of fiscal and monetary policies predates independence in Nigeria. Specifically, the origin of monetary policy could be traced to the establishment of Central Bank of Nigeria in 1958. The Bank was required under the statute to maintain a reserve of external assets consisting of all or any of the following: gold coins or bullion, sterling notes, coins and balances with the banks in the United Kingdom; treasury bills of 93-day maturity issued by the government of the United Kingdom; bills of exchange of 90-day maturity payable in the United Kingdom; sterling securities of 5-year maturity issued by the government of the United Kingdom and notes and coins of the West African Currency Board for a period of two years. The functions and roles of the Central Bank of Nigeria have evolved over time in line with independence and current economic realities.
The identified goals of monetary are to promote sustainable economic growth and stability, low unemployment, viable external balance position, price stability, and favourable macroeconomic environment that stimulate investment and production, cannot be achieved without vibrant real sector. Monetary and fiscal policies are expected to stimulate output and capacity utilization of manufacturing industries in Nigeria. This largely explains the prominence of manufacturing sector receives in policy formulation [4].
The objective of this paper therefore, is to explore the roles of monetary in promoting vibrant manufacturing industry in Nigeria. The paper also reviews the recent foreign exchange demand management of the Central Bank of Nigeria with

the objective of highlighting the opportunities the policy has provided for manufacturing companies in Nigeria. To achieve these objectives, the rest of the paper is structured as follows: Section 2 reviews monetary policy initiated in the past to promote Nigerian manufacturing sector. Section 3 places the analytical spotlight on Central Bank of Nigeria recent foreign exchange reforms. Section 4 identifies the challenges confronting manufacturing industries in Nigeria and the opportunities the reforms provide for the manufacturing sector in Nigeria, while section 5 concludes the paper.

2 Monetary and Fiscal Policies Initiatives to Promote Nigerian Manufacturing Sector

Historically, monetary policy in Nigeria is inextricable in the pursuit of economic growth and stability. They are macroeconomic management tools used to influence outcomes in the real economy to its desired direction. Monetary policy is expected to promote private sector investment through linkages such as stimulating the flow of credit to the real sector and ensuring stable foreign exchange. The efficacy of the linkages, to large extent depend on the ability of monetary authority to design and implement appropriate interest rate structures, instituting payment system that is credibly and expeditious in consummating transactions, developing exchange rate mechanism that stems wide fluctuations in exchange rate, promotion of sound and resilient banking system, and effective financial inclusion policy [5].

The basic goals of monetary policy therefore, are the promotion of stable prices, sustainable output and employment. In macroeconomic theory, monetary policy is expected to affect the real economy through movements in interest rates which would alter the cost of capital and investment in the productive sector. According to Mishkin (1996 and 2007) monetary policy influences the economy through a variety of channels — interest rates, credit and/or bank lending, asset prices via exchange rates, equity and housing prices [6].

Monetary authority has been consistent in designing and implementing programmes that are geared towards promoting Nigerian manufacturers. However, the current realities seem to suggest otherwise. The steep decline in oil price from above USD100 per barrel to below USD50 per barrel has imposed serious budget constraint on the government and hindered the Central Bank of Nigeria’s reserves accretion ability [12]. The feasible signs of the effects of dwindling oil price on the economy are apparent, the GDP growth rate which has been revised downwards for two consecutive quarters and budget constraints. Figure 1 depicts the trend of oil price and Nigeria’s foreign reserves between January 2014 and August 2015.

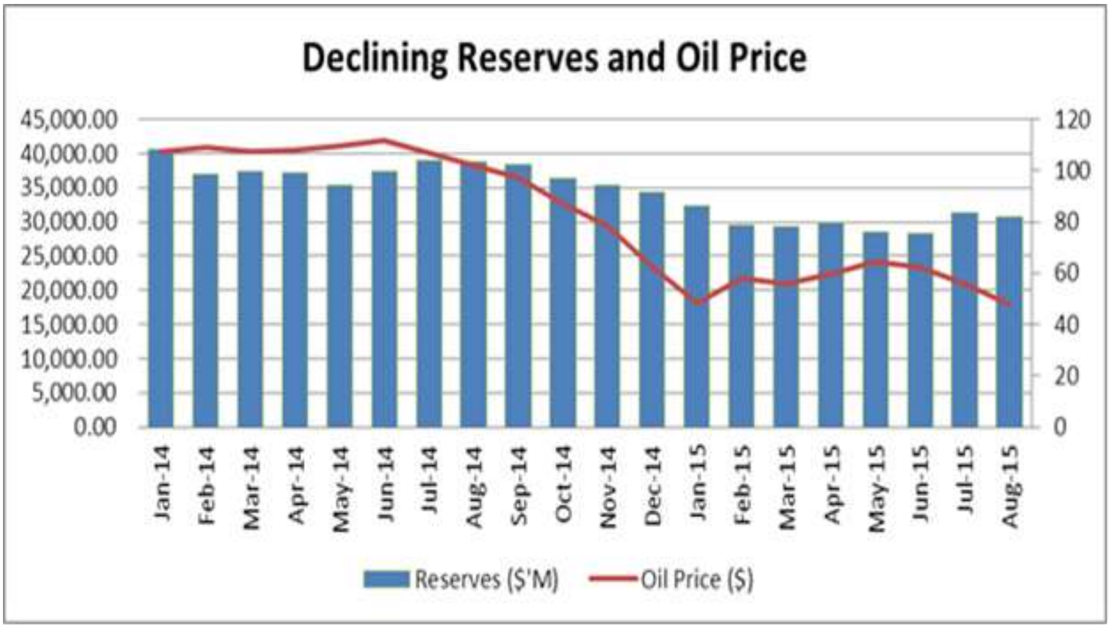

Fig. 1: Trend in Global Crude oil Price and Nigeria's External Foreign Reserves
Source: Central Bank of Nigeria Database

Despite the programmes and policies pursued by monetary authority in the past, it is apt to state that one yardstick for assessing the effectiveness of macroeconomic policies is the performance of the real Sector. Government policies can only be deemed successful if they impact positively on the production and distribution of goods and services. A vibrant and productive real sector creates more linkages in the economy and promotes internal and external balance.

2.1 Monetary Policy Initiatives

The CBN has at different times pursued expansionary and contractionary monetary policy with the ultimate goal of promoting economic growth development. The CBN embarked on expansive developmental function after the 2007/2008 global financial crisis by designing and implementing of suites interventions to increase credit to the real sector [13][8]. Some of these policies were aimed at mitigating the adverse effect of the 2007/2008 global financial crisis on the Nigerian banking system [9].

To maintain stability and deepen liquidity in the system as well as promote its developmental mandate, the CBN embarked on a series of interventions targeted at providing funds to the private sector to promote investment and growth. Table 1 provides a summary of the series of interventions

Table 1: Some Selected CBN Interventions

	Programme	**Year**	**Target Group**	**Nature of Intervention**
1	Agricultural Credit Guarantee Scheme Fund (ACGSF)	1978	Small Scale Farmers	Fund provides 75 per cent guarantee in respect of loans granted by banks for approved agricultural purposes and interest rebate to farmers. Loans guaranteed were below N10.0 million. Substitutes to collateral securities are allowed for group or small-scale or microenterprise loans extended on short-term basis
2	Interest Draw Back (IDP)	2003	Farmers under the ACGSF	Interest rebate of 40 per cent to famers who fully repaid as scheduled
3	The Agricultural Credit Support Scheme(ACSS)	2006	Medium Scale Farmers	Loans granted were above N50.0 million and with interest rebate of 6 per cent when repaid on schedule. It is an initiative of the FGN & CBN with the active support of the Bankers' Committee. It is a virtual fund of N50.0 billion
4	N200billion Commercial Agricultural Credit Scheme (CACS)	2009	Commercial Agricultural Enterprises	Financing of commercial agricultural enterprises at single-digit interest rate (9%)
5	Nigeria Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL)	2010	Farmers and agricultural value chain	De-risking financing of the agricultural value chain and providing farmers with affordable financial products
6	N200 Billion SME Refinancing/ Restructuring Facility for Bank Loans to Manufacturing (SMERRF)	2010	Manufacturers	Refinancing/restructuring of banks' existing loan portfolios to manufacturers
7	SME Credit Guarantee Scheme (SMECGS)	2010	SMEs, agriculture value chain, and educational facilities	To provide 80 per cent guarantee to credit to manufacturing SMEs, agriculture value chain, and educational facilities.
8	Microfinance Policy, Regulatory and Supervisory Framework for Nigeria	2010	Power & Aviation Projects	Provision of long term funding for power and aviation projects at single–digit interest rate

3 Recent Monetary Policy Reforms

The CBN has introduced a good number of policy reforms in the recent times, given the realities of dwindling oil price and its macroeconomic shock in Nigeria. Figure 2 presents a snapshot of the relationship between exchange rate movement and crude oil price. These reforms, whose overall objective is to stabilize the macro-economy of Nigeria, is specifically are aimed at preserving the domestic currency value; ensuring the external balance as well as the internal balance; and maintaining a favourable external reserve, among others.

Foreign Exchange Restriction on Selected Items: In the bid to reduce pressure on the foreign reserves and encourage local industries, the CBN issued a circular restricting the accessibility of forex for the importation of 41 items into Nigeria. The forex funding of the excluded 41 items from importation list are to be financed from sources outside the Nigerian banking system (see table 2 for sectoral utilization for transactions valid for foreign exchange).

a. Closure of the RDAS Foreign Exchange Window: The CBN closed the Retail Dutch Auction System (RDAS) and Wholesale Dutch System (WDAS) Foreign Exchange Window on the 18th of February, 2012, so as to preserve the country's external reserves, reduce the attack on the naira, and curb the practice of round tripping.
b. Adjusted the Exchange rate from N155/$1 to N197/$1.
c. Curtail the acceptance of foreign currency cash deposits into domiciliary accounts.
d. Reduced limit for use of naira debit cards for transactions overseas to $50,000 from $150,000 per person, per annum in April 2015.
e. Reduction in foreign exchange net-open-position (NOP) limit to 0.5 per cent of shareholder's funds to curtail speculative attacks.
f.

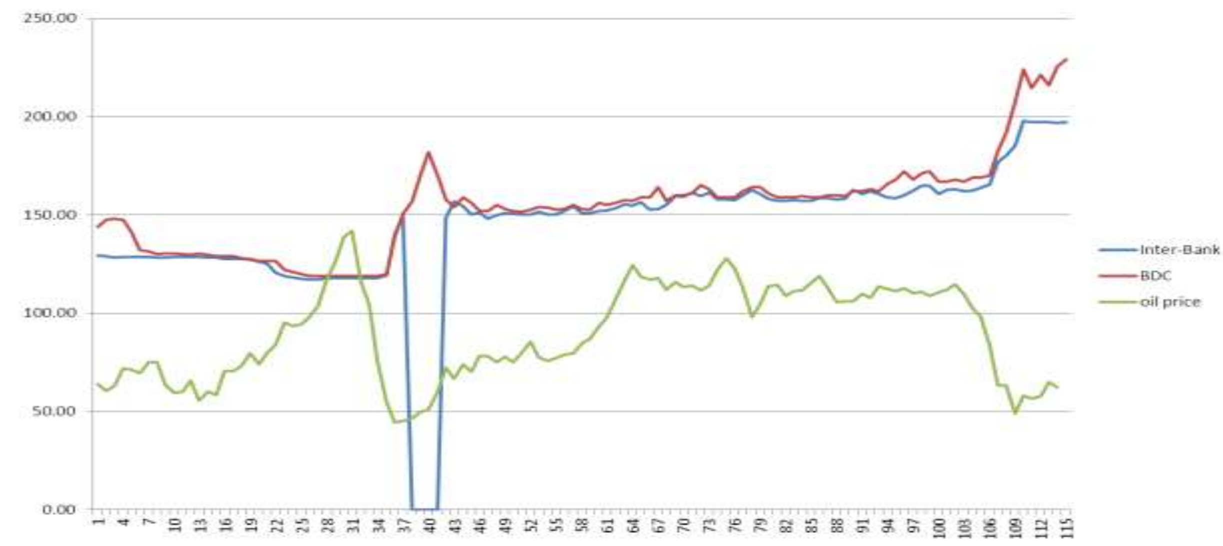

Fig. 2: Exchange Rate Depreciation and Oil Price

Table 2: Sectorial Utilisation for Transactions Valid for Foreign Exchange

Sectoral Utilization for Transactions Valid for Foreign Exchange (Percentage Share)										
S/No	Descriptor	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15
2	1. INDUSTRIAL SECTOR	16.61	18.14	17.65	18.73	17.73	19.14	16.17	17.57	**15.67**
3	2. FOOD PRODUCTS	13.21	7.93	8.77	10.24	10.17	7.03	5.50	4.81	6.23
4	3 MANUFACTURED PRODUCTS	8.79	8.53	10.21	9.95	10.73	9.30	7.41	8.08	9.86
5	4. TRANSPORT SECTOR	2.62	2.03	1.39	1.68	1.98	2.71	2.81	2.49	1.85
6	5. AGRICULTURAL SECTOR	0.11	0.37	0.30	0.83	1.47	1.20	0.33	0.40	0.48
7	6. MINERALS	1.10	0.37	1.15	1.38	1.36	0.56	1.34	0.58	0.69
8	7. OIL SECTOR	20.58	18.68	20.58	15.98	19.84	12.76	21.11	22.14	**10.71**
10	1. BUSINESS SERVICES	4.47	2.94	2.58	3.86	1.79	3.08	3.81	-0.93	-1.18
11	2. COMMUNICATION SERVICES	1.61	0.61	0.60	1.00	1.88	3.00	2.45	0.31	1.11
12	3. CONSTRUCTION AND RELATED ENGINEERING SERVICES	0.68	0.06	-	0.26	0.06	0.04	0.02	0.02	-
13	4. DISTRIBUTION SERVICES	0.00	0.03	0.34	0.34	0.09	0.15	0.03	-	0.06
14	5. EDUCATIONAL SERVICES	0.72	0.90	0.84	1.16	1.28	1.13	0.91	2.64	3.18
15	6. ENVIRONMENTAL SERVICES	-	-	-	-	-	-	-	-	-
16	7. FINANCIAL SERVICES	27.09	36.61	33.60	31.09	29.33	36.47	33.73	37.01	**48.14**
17	8. HEALTH RELATED AND SOCIAL SERVICES	0.00	0.00	0.01	0.01	0.00	0.01	0.01	0.01	0.12
18	9. TOURISM AND TRAVEL RELATED SERVICES	0.59	0.98	0.00	0.26	0.58	0.25	0.33	0.38	0.01
19	10. RECREATIONAL, CULTURAL AND SPORTING SERVICES	-	-	-	-	-	-	-	-	0.00
20	11. TRANSPORT SERVICES	1.14	1.19	1.50	2.64	1.25	2.34	3.13	3.53	1.34
21	12. OTHER SERVICES NOT INCLUDED ELSEWHERE	0.69	0.63	0.50	0.59	0.46	0.82	0.91	0.93	1.72
22	TOTAL (A+B)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Central Bank of Nigeria Database

4 Challenges Confronting Manufacturing Industries in Nigeria

There are daunting problems that are very visible in the country's corporate environment, which could be classified into unfavourable macroeconomic environment and the weakness of regulatory frameworks to protect the entire spectrum of corporate stakeholders. There is, near lack of basic infrastructures, corporate frauds, tax evasion, inexperience management, incessant changes in government macroeconomic and fiscal policies, communal and civil unrest, among others in Nigeria. Governments and host communities have ways of meddling with the affairs of firms. In some other cases, corporate owners and managers deliberately embark on acts that serve more of self than the overall wellbeing of the affected firms.

A priori, weak business culture, poor access to capital, little technological skills, unlevel playing ground from foreign competitors because of economic openness, infrastructural deficit, policy vacillation, and the over dependence on developed economies for raw materials or intermediate products are the debilitating factors driving corporate failures in Nigeria.

On the other hand, Nigeria represents an environment where regulations are incapable of preventing managers and board members from appropriating earnings for selfish gains. The selfish interests of these individuals entrusted with corporate management and control can actually be directed at profit maximisation goals. Theoretical positions on the above issues have been historically laid down and the practical validity reconciled with developments in some developing economies. This problem is accentuated because of weak external governance, which allows firms to get away with loose adherence to rules and regulations about board independence.

On specificities, the greatest threat to Nigerian manufacturers is power. Because of epileptic power supply in Nigeria, most manufacturers use independent powers sources which are capital intensive and increase the cost of production. Other threats are sources of raw materials, inaccessible roads, multiple taxation, and import-related problems. The insurgency in Northern Nigeria has seriously affected the markets of most manufacturers. Specifically, the North is a perfect market for made in Nigeria, and export route for made in Nigerian goods to other countries such as Chad, Cameroon, Mali, Niger, among others. The insurgency, which has practically destroyed the economy of the affected cities in the North has adverse effects on manufacturers in Nigeria.

As stated earlier, security poses serious challenge to Nigerian manufacturers. For instance, security challenges such as kidnapping, arm-banditry, among others compel manufacturers to use security agencies for their daily activities, which increase the cost of doing business. Most Nigerians that would have ventured into manufacturing, especially, agriculture using cheap rural lands are discouraged because of lack of security, aside the near-absence of basic infrastructure.

4.1 The Opportunities the Reforms Provide for the Manufacturing Sector in Nigeria.

Despite the daunting challenges confronting manufacturers in Nigeria, there will still be light at the end of the tunnel. For instance, the recent exchange rate policies of the CBN have been lampooned by different strata of the society. Manufacturers have essentially argued that the policy has increase the cost of raw materials, and shot them out of business. Others have argued that what constitute raw material for a particular manufacturer might constitute finished product for another manufacturer. Thus, the advocacy centered on using the HSB Code.

These problems notwithstanding, we as a country are at the point in our nationhood to take hard decisions. The exchange rate policies are trade-offs between having a country and having none. The reforms have provided veritable

opportunities for manufacturers to explore.
First, not allowing foreign exchange access to forty-one (41) items technically increases the cost of importation, which makes those items non-competitive. This has created the opportunity for manufacturers to innovate ways of manufacturing the items locally. Though, the ability to achieve this is dependent on factors, such as technology and patent rights. These challenges are however no insurmountable. Nigerian manufacturers could negotiate with their foreign partners on strategies for domesticating such technology and buying the patent. The intuitive appeals of this business model are, it creates productive employment, promote skill and technology transfer, and reduces import-dependence. This kind of business model will surely attract funding from the government.

Second, historical narratives have shown that most great nations, at some point in their economic history close their borders to imported goods. The universal slogan was “what we do not have, we do not need”. This economic thinking is innovating, enriching, and most importantly, helps us as a nation to discover and harness our untapped potentials. However, it is the duty of manufacturing sector to champion the crusade.

It is also imperative to rethink the current power generation and distribution arrangement in Nigeria. The decentralisation of power generation and distribution should be considered by the government, instead of depending on the national grid, states should be empowered to generate and distribute their own power. In addition, apart from making the power sector more flexible as obtainable in the communication sector, for better operations the manufacturers should legally be empowered to generate their electricity.

5 Conclusion

Monetary and fiscal policies are important tools for ensuring macroeconomic stability. The history and usage of these tools predates independent Nigeria. The effectiveness of these policies to a large extent depends on factors such as the development of the economy, diverging economic needs and structural rigidities that impedes on the transmission channels.
The recent trend in the international oil price, which resulted in reserves depletion, dwindling government revenue, budget constrain and inter-temporary constrains has brought to the fore, the urgent need to rethink economic management.
This economic rethinking, no doubt, has interim adverse implication on economic agents, especially, manufacturers. However, it is imperative that we collectively strive to optimize the situation, in terms of innovating strategies to leverage from the present situation. Such strategies could focus reducing import dependence, promoting technological advancement and enhancing skills transfer.

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