Global Financial Crisis And The Nigerian State. An Appraisal Of Banking Reforms In Nigeria

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Abstract

The world at large is facing one of the most difficult times in history. Likewise the world economy is also facing the most severe financial crisis ever witnessed since the Great Depression of the 1930s. The risk of global financial crisis has heightened and threatened significantly local banks in Nigeria due to the collapse of stock exchange markets and over-valuation of assets. Some perceived the financial crisis as a crisis triggered by a liquidity shortfall in the United States banking system caused by overvaluation of assets. Yet, some others see it as inherent ideological disaster associated with capitalist production and its market-driven economic reforms. In Nigeria, the causes are premised in the volatility posed by the economy which poses significant challenges to macro-economic stability, lack of corporate governance at banks, critical gaps in regulatory framework among others. This study examines the corrective measures taken by the state in repositioning of the banks as a mechanism for sustaining the Nigerian economy as well as inflow in foreign investments in Nigeria. It explains the legal issues of the reform, especially tenure limit of CEOs and non-executive directors as well as how this will ensure economic stability in Nigerian economy.

Introduction

The global economic crisis of 2007 was triggered off by the failure of the capitalist financial systems, due to liquidity shortfall especially in the United States and over valuation of assets. It has resulted in the collapse of large financial institutions, the bailout of banks by national governments and downturns in stock markets around the world (Wikipedia, 2008). In many areas, the banking industries have suffered setbacks and economies of countries such as Greece and Spain have also suffered significant decline in economic activities.

The financial crisis is merely a symptom of another deeper crisis, which is systematic crisis of capitalism itself. According to Samir Amin, the constant decrease in GDP growth rates in western countries since the early 1970s created a growing surplus of capital which did not have sufficient profitable investment outlets in the real economy. The alternative was to place this surplus into the financial market, which became more profitable than capital investment, especially with subsequent deregulation (Amin, 2008:18). According to him, this phenomenon has led to recurrent financial bubbles and is the deep cause of the financial crisis of 2007-2010.

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These factors acted individually and collectively to bring the entire Nigerian financial system to the brink of collapse. These factors led to the current policy reforms introduced by the CBN governor, Lamido Sanusi.

The aim of this paper is to appraise the policy of the bank reforms drawing from the eight factors above and actions taken by the state in stemming the rising tide of bank failures in Nigeria.

Understanding Financial Crisis and Bank Reform

The impact of the financial crisis on the Nigerian economy seems to be minimal and limited as banks in the country refrained from investment. However, the crisis affects Nigeria in two ways. First, there is widespread of the financial crisis across borders and spillovers for stock market led to continuous downward trend in prices of stock for a long time now in Nigeria.

Second, the economic meltdown in the developed economies has significant impact on Nigeria. The Nigerian economy is directly or indirectly tied to the economies of the USA and Europe. This is because the peripheral capitalist accumulation is based on international division of labour in which the periphery exports primary commodities. The vagaries of the international market and the pricing system for these commodities mean that revenues from them are subject to sudden collapse which undermines the economy of the country. The channels of impact include the indirect effect of volatile and falling commodity prices, especially crude oil on export revenue and the inflow of capital into the country, low aids, low foreign direct investment and portfolio investment. Although many commentators have argued that Nigerian economy is partially insulated from the direct effects of the financial crisis, but our economy is integrated into the economies of Europe and America to a very large extent.

First, the effects on Nigerian economy come in the form of foreign direct investment and equity investment. As the economies of the West continue to witness serious economic crisis so will the economies of the periphery continue to come under serious pressures. These crises were witnessed in equity and project finances which have been weakened. The fall of inward investments suffers and affects important sectors of the economy such as agriculture, infrastructure development, health, and education (Mtango, 2008). As a result, withdrawals of portfolio investment due to the contagious nature of the crisis had already caused a reduction in stock prices in Nigeria.

Second, a remittance to Nigeria has been on the decline due to the recession. This is because Nigerians abroad are under pressure due to loss of jobs and may not be able to remit money back home as they have done in the past. The implication for the economy is that Nigerians in diaspora will have little or nothing to invest in the economy.

Third, aid budgets are under pressure due to the problem of debts and weak financial positions of donor countries. Financial crisis in Greece, Spain, Portugal, and other European countries is a dangerous sign that aids budgets are now under increased pressure and is likely to affect the Millennium Development Goals of most third world countries, particularly Nigeria.

borrow in order to meet the cost of living. There is a direct relationship between decline in wealth, and decline in consumption and business investment, which along with government spending, represent the economic engine. The output of goods and services produced by labour and property in the United States decreased at an annual rate of approximately 6% in the fourth quarter of 2008 and first quarter of 2009 when compared with the activity in the year-age periods. The U.S. unemployment rate increased to 10.1% by October 2009, the highest rate since 1983.

In Europe, one of the long-term worldwide consequences of the economic breakdown is the 2010 European Sovereignty crisis. This crisis primarily impacted negatively on Greece, Portugal, Italy, and Spain. Thus, the world economy was hit by unprecedented financial and economic crisis in 2007, and tipped into recession by the sub-prime crisis in the US in August 2007. Therefore, this crisis led to the collapse of many world renowned financial institutions and even caused an entire nation to be rendered bankrupt.

The direct impact of the crisis on the African economies has this far been limited as most commercial banks in Africa refrained from investing in the troubled assets from the US and other parts of the world. However, the Nigerian stock market has experienced a continuous downward trend in prices of stocks for sometimes now, and as such, the stock markets all over the world have significantly witnessed downward drop in their market values and trading.

Background to Bank Reforms in Nigeria

Since the beginning of the 1980s but especially with the Babangida's administration, there has been a decisive swing in the dominant intellectual attitudes and development strategy away from state initiative, ownership and the rolling back of the spheres of state action (Adebayo, 1993:16). This change has been first and foremost generated by a number of factors which include the perceived success of the Newly industrialized Countries (NICs) which place greater reliance on the state than on market, the coming into power of conservative regimes in Britain and the U.S., which encouraged the widespread of capitalist economic doctrines and ideology due to the collapse of the former Soviet Union and socialism; and deep and extensive macro-economic and social crisis facing less developed countries. These crisis have been generally blamed on mismanagement, inefficiency and the wrong economic policies pursued by most developing countries, especially the strategy and public ownership of enterprises have been emphasized as the causes of distortions, slow growth and the multiplications of inefficient structures (Adebayo, 1993:17).

The implementation of economic reforms was geared towards the correction of these distortionary polices. Milton Friedman and Fredrick Hayek provided the foundation for the new reforms by introducing the neo-liberal economic policies. Their works underscored the concept of the classical market economic model, which restricted state role to an economic watchman. World Bank and the International Monetary Fund (IMF) soon adopted this reform strategy as a development one, putting it as a condition for loan,

Generally, the link between democratic transition and economic progress in African has been argued in three different ways by authoritarian regimes, International Financial Institutions (IFIs) and their neo-liberal social Scientists, as well as popular forces. First, for authoritarian regimes, democracy and economic development are separate and should be pursued consecutively, with democracy only coming after economic development. The position adopted by some African scholars in reaction to this position is also that they are separate and consecutive, but in reverse order. So Anyany' Nyongo (1987:20) argues that ".... Political liberties and accountability of the state to the people in particular the popular classes is a precondition for material progress".

Secondly, for the IMF, the World Bank and neo-liberal social Scientists, the relationship is posed as one between market-oriented economic reforms (structural adjustment) and democracy (political liberalization). Its context is the so- called political conditionality for aid demanded by Western government and IFIs from African's authoritarian regimes since the end of the cold war. However, political liberalization and economic reform are posited as separate, but should be pursued concurrently. In reaction to the common charge that there is a link between structural Adjustment Programmes (SAP) and economic repression (Ibeanu and Nwaosu, 1988, Oyediran and Agbaje, 1991; Przeworski, 1991), IFIs and their "thinkers" insist that SAP is not necessarily antagonistic to democratization. It may give rise to social and political tension, but that does not mean that it necessarily result in political repression. The protagonists have come to accept that economic reform is a necessary burden on democratizations and antagonistic to it.

Writing on Latin America situation, Lechner (1991:541) argues that 1980s saw a situation of contrast: democratic governments are taking over throughout the region, while at the same time a profound economic crisis is shaking the structures of society. They reflect ambiguities in conceptualizing the link between the state and economy in the so called transitional societies (Ibeanu, 2008:224). Consequently, Western nations and IFIs seem to agree on the weakening of the state's role in the economy through privatization and deregulation. On the other hand, they seek the emergence of strong states and Bonapartist regimes that can enforce capitalist regimes, keep popular demand in check and ensure political stability (Ibeanu, 2008:225). The support for strong presidential governments that continue to curtail rights and increase poverty through poor economic policies even as they profess democracy as engine of development remains a failure. In the mainstream discourse developed by Western leaders and IFIs, the state-reduced to government and political leadership were singled out as the primary factors responsible for non-development in Africa (Mangu, 2008:4). Yet strong states were for a very long time supported by the West and IFIs. However, under SAP, devised to promote development on the continent, the developmental state was then said to be a dictatorship of development (Sklar, 1996:1-30). Therefore, the reforms were a planned to achieve a minimal state.

Of particular relevance for our study, however, is the recent formulation of the state-economy connection found in the literature on transitions from authoritarian rule to

Nigerian economy, and making it boisterous and vibrant, there are formidable challenges, compounded and complicated by an inept and incompetent elite in leadership positions. (Jega, 2009:1)

Let us now discuss the eight factors leading to the financial crisis as enumerated in page four of this study.

Economic and Macro Prudential Management

Macro-economic issues are connected to the financial crisis. Oil maintains an overly dominant position in the Nigerian economy (Sanusi 2010:5). This introduces volatility and poses significant challenges to the macro-economic stability. As oil prices increased steadily between 2004 and 2008, government spending tracked the price of oil, making fiscal policy highly pro-cyclical. Consequently, variations in disbursement of oil revenues made it difficult for governments to manage economic development and caused tremendous instability as these varying amounts entered the banking sector. Simultaneously, according to Sanusi (2010:6) "the lack of an effective fiscal quarantining mechanism meant that the fiscal authorities failed to prevent this excess liquidity from reaching the domestic banking system. As amounts held in Nigerian deposits increased, banks were able to increase their lending". Consolidation in the domestic banking sector and with abundant capital increased the speed of credit creation. Bank deposits and credit, tracking the price of oil grew four-fold from the year 2004 to the year 2009, and banking assets grew on average at 76% per annum since consolidation. The CBN failed to halt this vicious circle and foresee the consequences. CBN macro-prudential management did not sufficiently address the impact of these oil-related inflows and the fiscal policy being pro-cyclical. This exacerbated the crisis.

Corporate Governance at Banks

Following the problem of macro-economic instability was the weak governance standards at the banks. The huge surge in capital availability occurred during the time when corporate governance standards at the banks were extremely weak. Hence, the failure in corporate governance at banks was indeed a principal factor contributing to the financial crisis. However, consolidation created bigger banks but failed to overcome the fundamental weaknesses in corporate governance in many of these banks. As Sanusi (2010:6) notes, "governance malpractice within banks, unchecked at consolidation became a way of life in large parts of the sector, enriching a few at the expense of many depositors and investors. Corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management." Essentially boards and executive management in some major banks were not equipped to run their institutions and the bank Chief Executive Officer (CEO) always had an overbearing influence on the board. Again, some boards lacked independence and directors often failed to make meaningful contributions to safeguard the growth and development of the

of prior bank reports on bank subsidiaries". Therefore, enforcement was the biggest failure among surveillance processes, despite the CBN having all the powers it needed to enforce examination recommendations.

Central Bank of Nigeria and Management Processes

One of the major factors that contributed to the problem was the governance and management processes at the CBN. This has a significant impact on its ability to drive its mandate effectively. This was because governance and internal processes were unstructured and this compromised the CBN's ability to supervise the banking sector. The CBN was not organized to monitor adequately and analyze the macro-economic issues and system risks inherent in the financial sector such as the global economic risks, federal/state economic development strategies and fiscal policies, formation of asset bubbles, exchange rate risk, capital market depth, informal sector economy etc (Sanusi, 2010).

Business Environment

. Finally, sufficiently developed business environment and infrastructure were absent and added more to the negative influence on the banking industry. Poor legal framework in terms of its long and expensive processes, an absence of reliable credit rating agencies and poor infrastructure all contributed in no small way to non standard banking practices in Nigeria. On the part of the customer, there were no basic information largely because there was no uniform way to identify customers, and consequently, leading to customers abusing the banking system thereby increasing the rate of bad debt in the system. These were the conditions of the banking industry before Sanusi's appointment as the CBN governor.

With the current global economic crisis, in which the economies of major western countries have been devastated by the banking and financial crisis, and are already being engulfed in a recession, the Nigerian economy, like those of other developing third world countries, is poised for a very rough and tough time. Already, our export earnings are being affected by the fall in commodity, especially crude oil prices. Our currency, the Naira, has suddenly depreciated against the US Dollar. Nigeria's foreign reserves have dropped from US$67 billion in June 2008 to US$53 billion in December 2008. There was a move to cut the budget at both federal and state levels given declining revenues from crude oil export. The first targets are bound to be in social spending, such as education, health, and other social services. All these suggest that, unless there is purposeful and focused leadership, with creative and intelligent handling of the economy, the impact of the global economic crisis on the Nigerian political economy would be profoundly negative and consequential(Jega,2009:2). As the Nigerian economy struggles in the face of the current global economic crisis, we need a leadership that can effectively meet the following challenges of Nigeria politically, economically, and socially.

The second and very crucial pillar in the four pillar reform programme is establishing financial stability. 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.

Policy on Bank Reforms in Nigeria

Why does the Nigerian economy feature recurring episodes of bank failure? The emergence of indigenous banks in the country almost immediately introduced collapse of deposit taking institutions in the country. Between 1947 and 1952, twenty-one out of the twenty-five indigenous banks in the country collapsed! With the over N400 billion capital injections into the banks last year through public offers alone, the banks witnessed the birth of a new era referred to as mega banking in Nigeria. But, grappling with multiple bank failures is one of the challenges of the post consolidation era (Osuji, 2010).

The earliest episode of collapse of banks in Nigeria was attributable mainly to regulatory gap as it came well before the Central Bank of Nigeria (CBN) was established. Whereas the earliest indigenous banks rapidly multiplied between 1920 and 1930s, the first banking regulatory instrument came into effect in 1954. However, there was an acute shortage of skilled human capital and experience in managing the banks at that time. Furthermore, the mushroom banks setup by local entrepreneur were bedeviled with insider loan abuses and were inadequately capitalized, thus they could not compete with foreign banks operating in the country at that time (Histo-Regulatory Perspectives on Bank Failures in Nigeria, 2006:1).

Over 95% of the licensed indigenous banks owned by local investors were liquidated by independence in 1960. This model of bank ownership was replaced by government ownership after independence. The philosophy was that banks were development agents and they became an integral part of Nigeria's economic nationalism. Apart from the Federal Government setting up new banks it also acquired controlling stakes in the foreign banks in the country. Some state governments also started their own banks. The remarkable point to note is that prudential regulation of the banks were basically compromised as the CBN was concerned that the banks complied with sectoral loan allocation guideline determined by governments development programme rather than commercially determined well managed risk portfolio. Furthermore, the relevant governments continued to prop up the banks far beyond when their dirge would have been sung (Histo-Regulatory Perspective of Bank Failures in Nigeria, 2006:1).

The introduction of neo-liberal economic policies in Nigeria in the mid-eighties returned the country to the private ownership model with over 80 banking licenses granted mainly to local private investors. It was this era that introduced the issue of bank distress and outright bank failures. Depositors lose their money in the failed banks characterized by weak regulatory regime further hampered by large number of banks beyond the effective capacities of the regulators, gross insider abuses, outright criminality

The issue arising from the CBN's guideline is that it could be interpreted as an implied removal of the affected CEOs albeit from a future date. The CBN's power to effect the removal of the CEOs consequently needs to be investigated from at least two perspectives. The first is legality. This requires subjecting the guideline to the provisions of the apparent enabling statues- CBN Act 2007 and Banks and other Financial Institutions Act (BOFIA) as well as the Constitution. The second aspect of the scrutiny goes beyond legality and constitutionality by looking at the CBN's guideline in the light of theoretical and practical questions of regulation and intervention in apparently private affairs (Osuji, 2010:1)

The twin issues are one of 'right'. First, there is the question of the (legal) right ('power') of the CBN to issue the guideline. Irrespective of the answer to the first question, the second issue is the right (that is the 'appropriateness') of the state or an agency of the state (the CBN) to intervene in private arrangements generally and in the particular case of management of banks.

Between 1991 and April 2003, 36 banking licenses were revoked by the CBN in compliances with sections 12 and 36 of Banks and other Financial Institutions Act (BOFIA) 1991, as amended and the .banks were handed over to the Nigeria Deposit Insurance Corporation (NDIC) for liquidation as provided in section 38 of BOFIA. Section 33 of BOFIA vested on the CBN powers over failing banks. It provides that where a bank informs the CBN that (a) it is likely to become unable to meet its obligations under this Decree (Act) or (b) it is about to suspend payment to any extent; (c) it is insolvent; or (d) where after an examination under section 32 of this Act or otherwise however, the bank (CBN) is satisfied that the bank is in a grave situation as regards the matter referred to in section 32 (1) of this Act, the governor may by order in writing exercise any one or more powers, specified in subsection (2) according to BOFIA, among others includes to prohibit the banks from extending any further credit facility, remove directors, appoint any person to advise the bank. Appoint any person as director of the bank among other functions. Incidentally, the CBN's guideline expressly provides that it applies notwithstanding contractual provisions on the tenure of bank CEOs.

As previously pointed out, the legality of the CBN's action depends on the relevant statutory provisions. Specific provisions of Bank and other Financial Institutions Act (BOFIA) relating to qualifications of directors and officers of banks appear to be in section 19, 33 and 44. It seems that none of the provisions expressly permits the CBN to issue a guideline restricting the tenure of bank CEOs. Section 19 prohibits employment of bankrupts and persons convicted of offences involving fraud, dishonesty or professional misconduct. It also prohibits joint directorships of banks and engagement of bank directors in any other business or vocation. Section 19 does not in any way authorize the CBN to limit the tenure of CEOs or prevent banks from engaging their CEOs for more than 10 years.

The theme of qualification as a bank director is also contained in section 44. Section 44 disqualifies the following from being directors or continuing as directors of banks: persons of unsound mind, bankrupts, persons convicted of fraud or dishonesty and

There is one view that banks are private enterprises and, as a result, there is the need to encourage free enterprise and entrepreneurial spirit instead of interfering in their affairs. However, insisting that banks are private institutions and their affairs are private is a weak argument (Osuji, 2010:3). The recent local and world financial crisis, at least, has clearly demonstrated that this argument is spurious and supposititious. It is evident from the interventions of governments and state agencies including the bailouts of banks and provision of stimulus packages for the economy that banks are not exclusively private institutions.

The issue of whether the right of the state to intervene in banks is justified is the question of the regulatory appropriateness of the intervention. What is corporate governance is the critical issue here. Corporate governance is a concept that encompasses internal corporate processes and structures in as well as society's (including the state) mechanisms for controlling the internal and external operations of corporations. Issues in corporate governance include the existence, membership, role, control and effectiveness of internal structures such as the board of directors, non-executive directors and the members in general meeting (Osuji, 2010:3).

In looking at the broader question of interference in private arrangements in banks, the key questions include whether internal control or self-regulation by banks individually or as an industry would have been more effective; and whether shareholders can be trusted to ensure proper governance of banks. Without going into details, it is apparent from the recent and persistent banking failures and scandals in Nigeria that proper corporate governance and effective internal control mechanisms, including shareholder control, in banks are either non-existent or at least severely attenuated in many banks. A corporate governance model base on shareholder control and other internal mechanisms has not worked with many Nigeria banks. The result is that the CBN cannot effectively perform its role of ensuring financial stability and promoting a sound financial system without intervening in apparently private arrangements in banks. CEOs's tenure is presumably one of such arrangements that affect internal corporate governance and the national financial system (Osuji, 2010).

Tenure Limit for Bank Directors

In the aftermath of 2009 shake up in the banking industry and the wave of apprehension that gripped depositors, the CBN initiated far-reaching reforms to sanitize the sector and restore public confidence. The first casualties of the reforms were seven bank MD/CEOs. Subsequently to their removal, the apex bank decided to limit the tenure of bank CEOs to a maximum of ten years. The idea is that after ten years in office, bank CEOs do little more than building monuments to their egos.

Only recently, the Governor of CBN, Sanusi Lamido Sanusi announced, yet again, a maximum tenure of 12 years for non-executive directors of banks. This is, however, subject to two renewals of the initial term of four years. Each term is subject to confirmation by the apex bank. Under the new guideline, CBN reserves the right to reject the renewal of the term of any director when the first one elapses (Vanguard, 2010:12).

mentioned eight interrelated factors that led to the creation of an extremely fragile financial system that tipped into the global financial crisis and recession. These factors led to the current policy reforms introduced by the CBN governor. Nigeria government is trying to contain the crisis through rescue packages and administrative reforms in the banking sector. This follows the four pillars enumerated by the central bank governor. These include enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution, and ensuring the financial sector contributes to the real economy.

What Sanusi has started seems contingent and comprehensive upon the need for macro-economic development. As Nigerian economy and its banks struggle in the face of current global economic crisis, the banks currently need a leadership that can effectively meet the challenges of taking creative, independent and insightful decisions in handling the current crisis. The CBN was probably right to issue the tenure limit guideline. This does not suggest usurpation of power by the CBN. Beyond the legal question, the CBN was also right to interfere with private arrangements in banks in order to ensure the proper governance of the banks and a sound financial system in Nigeria.

As the banking reform moves to the stage of growth by incentives, it is very important that the banking sector regulators continue to monitor the banks, their CEOs and non-executive directors in the areas of good governance, prudential guidelines and compliance with other specific regulatory policies guiding their operations. The CBN should continue to develop capacities to govern the fiscal and monetary policy process and framework that will be the engine of growth in the Nigerian economy. Therefore, the financial sector and overall economic success will require the CBN to do a lot in the area of policy process. This include ensuring that physical and institutional infrastructure is of a scale and quality required. In addition, it calls for political will to act to reduce corruption and uphold the rule of law. This will help the country move away from the structurally-compromised character it bears today.

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