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<td>AGU, Cletus Chike</td>
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CLETUS CHIKE AGU

THE ROLE OF COMMERCIAL BANKS IN MOBILIZATION AND ALLOCATION OF RESOURCES FOR DEVELOPMENT IN NIGERIA

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CARITAS
THE ROLE OF COMMERCIAL BANKS IN MOBILIZATION AND ALLOCATION OF RESOURCES FOR DEVELOPMENT IN NIGERIA

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1. Introduction

The need to develop domestic financial market institutions and patterns of behaviour necessary to generate and mobilize scarce capital funds as a key condition originated in the classic work of Schumpeter 1. Since then so great an interest has been aroused among students that the role of financial institutions, particularly commercial banks, in the economic development of the developing countries has come under increasing scrutiny by students, as shown in the studies of a small but growing band of economists such as Gurley, Shaw, Goldsmith, Adelman, Morris, Cameron, McKinnon and others 2.

Although the relative magnitude of the impact attributed to banks and other financial institutions in developing countries differ among these authors, there is an acceptable consensus that financial resource is a very important, if not the most important factor, in economic development 3. However, empirical research has neither proved nor disproved that financial resource is the key performance indicator of developments in the developing economies 4. Nevertheless, there is a considerable body of historical evidence to substantiate the relationship between financial resources and economic development. For instance, the variety of theories of economic development ranging from Harrod-Domar type «growth model» to Rostow type «take-off» theories have one thing conceptually in common: it is the notion that the availability of savings is a precondition of continuing growth 5.

5. Rostow noted: «virtually without exception, the take-off periods have been marked by the expansion of banking institutions which expanded the supply of working capital, and in most cases also by an expansion in
Having accepted the historical evidence that financial resource is very important for economic development, then mobilization of financial resources from both internal and external sources becomes crucial in achieving rapid economic take-off in developing countries. For an economy that wants to increase its real capital formation, the objective must be to provide a climate receptive to importation of resources from outside and the encouragement of domestic savings. Since financial resource mobilization problem is very closely tied up with savings problem the latter approach requires an institutional arrangement which encourages and mobilizes savings on one hand, and which channels savings so mobilized into productive investment on the other.

Developing countries are generally characterized by low rate of domestic savings. However, the inadequacy of domestic savings rate seems rather exaggerated. With few exceptions, namely the very poor countries, the gross domestic savings rate has been found to be fairly high in large number of developing countries. What is really lacking is the efficiency in the process by which savings being accumulated in the economy are translated into savings suitable for productive investment. Maintenance of high investment level is largely a function of domestic savings performance, capital inflow from abroad serves more as a catalyst and as a factor in relaxing foreign exchange constraint than as a major factor in supporting rising levels of investment. Besides, foreign capital, no matter how large the inflow, cannot absorb a recipient country from the task of mobilizing domestic resources. In developing countries' experiences have shown that foreign capital alone cannot create any permanent bases for higher standard of living in future and that greater dependence on domestic sources of finance facilitates more the successful implementation of any planned economic development.

Greater dependence on domestic sources of capital, therefore, requires a wide range of independent well organized and adapted financial institutions which have to mobilize internal resources for the purpose of capital formation and allow the capital to be

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7 See V.V. Bathla and Jacob Meerman « Reserve mobilization in developing countries: financial institutions and policies », World Development, 1979 vol. 8, No. 1, p. 48.
Involved conveniently and freely into desired development ventures. Commercial banks, the basic component of financial institutions, should be thus the major relevant institutions which encourage and mobilize savings and channel savings into productive investment first, because of their network of offices, second, because commercial banks through normal credit operations often activate savings lying idle elsewhere, and third, because the banks' liabilities which are part of money supply are highly liquid and thus attract savers. The purpose of this paper thus is to explore in the light of past trends, the role and scope of commercial banks as financial intermediaries in mobilizing domestic financial resources for development and the constraints in the efficient performance of this role.

2. Intermediation role of commercial banks

Intermediation is the main macroeconomic function of commercial banks. Commercial banks are financial intermediaries because of their intermediation role. Intermediation is defined as the process of mediation through institutions and instruments, between primary savers and lenders and ultimate borrowers. It is the process of collecting savings by financial institutions and their channelling of the savings to investors. At the rudimentary level of financial development, where savers are users of their own funds, capital formation can take place without generating financial assets at a very limited extent thereby limiting very seriously the rate of economic development. But with the development of borrowing in the stage of financial development, decisions to save and invest became separated. Thus the mechanism to bridge this dichotomy becomes essential. This mechanism can take two forms: (i) the creation of financial liabilities on primary securities whereby funds of the surplus economic units are transferred to deficit economic units. This is the direct channelling of funds of surplus spending units to deficit spending units (ii). Indirect financial claims consisting of demand and savings deposits via the commercial banks or other financial intermediaries from where funds of the surplus economic units are made available to those wanting to spend on real capital investment.

It is noteworthy that for a variety of reasons such as the risk of default, risk of capital loss, risk of loss of value due to inflation and risk of liquidity the first method — the direct channelling of funds from savers to investors — has declined in importance.

8. See D.A. Khakhah and E.N. Rechel op. cit.
Furthermore, the availability of a wide menu of portfolio choices of instruments to the public has made the method less attractive. Direct placement of financial liabilities with surplus units seriously limits the volume of savings mobilized and reduces the dependence of investors on external sources of finance. Investors depend on their own funds or retained earnings which in turn limit the size of feasible investment. A developed financial market should provide actual and potential savers and borrowers with the opportunity, the choice and information necessary for optimum savings and allocation of investment within a competitive system. Thus efficiently operating financial market enhance the rate of domestic savings. Implied is that the existence of adequately developed financial markets also means that the decision to save and the decision to invest need not be taken by the same economic unit. Commercial banks through their intermediation role between savers and investors affect the volatility as well as mobilization of savings, by providing the market with the diversification of instruments that will meet the precise liquidity needs of savers and at the same time making financial resources available to the investors over a relatively long period in accord with their needs. Since they operate with larger portfolios than individuals, commercial banks are less exposed to the effects of default or variation in income or capital value. These advantages they pass on to their depositors so that the liabilities they issue — deposits — are less risky than the individual loans or investments the banks hold in their asset portfolio. Unfortunately there has been a limited appreciation of the influence of financial technology embodied in the quality and variety of financial instruments developed by financial institutions, on savings and capital formation in developing countries such as Nigeria due to the dominant influence of Keynesian macroeconomic development. According to the standard Keynesian macroeconomic theory:

\[ S = f (I, W) \]

where

- \( S \) = Rate of savings
- \( I \) = Income

Financial technology is not among the explicit arguments of the above equation. The reason for this omission can be traced to the Keynesian "portfolio balance" theory which divided wealth accumulation into sets of sequential decisions—the decision to save and then the decision to hold the savings in some form of wealth, which involves asset choice. The portfolio balance approach assumes that the decision to invest precedes the decision to save and consequently, the availability of different kinds of financial assets which provide a degree of choice in the portfolio balancing process, will not influence the level and rate of savings. Because synchronization of the receipt and disbursement of income is an important objective of saving entities, the kind of financial instruments made available by financial intermediaries will affect the magnitude of savings. Savings, therefore, cannot be regarded as a given datum available for portfolio choice. The volume of savings is influenced by financial technology and therefore equation (1) may be respecified as:

\[ S = f (t, i, W, I) \]

where

\[ t = \sum A_j \]

and

\[ A_j = \] the monetary value of the nth asset of the jth institution of the financial market.

The technology (t), however, depends on a number of factors: the extent to which the business units depend on external sources for their finance, and how much on internal financing, the degree of reliance on the financial system for promoting economic growth, the degree of monetization of the economy, and how far intermediation by financial institutions satisfies the portfolio preferences of both lenders and borrowers by transforming the obligation of the borrowers into a more attractive set for lenders by reducing the level of risk associated with it. In economies where dependence on internal finance is high and where the degree of monetization is low, the role of the financial system in the co-ordination of savings and investment decisions may be only peripheral. Most investment is self-financed so that independent savings and investment decisions may involve only relatively small proportions of total saving and investment operations. There are also other techniques of collecting savings and channeling funds to investors such as centralization of investment and the use of fiscal instruments.
3. The performance of commercial banks

3.1. Density of Bank Offices

It is usually argued that the problems of promotion and mobilization of savings in Nigeria, and in fact other developing countries, are caused by inadequacies in the structure of financial markets, and the density of financial intermediaries. Support for this argument has come from some empirical evidence that has shown savings to be responsive to the number, availability and efficiency of financial markets. One of the reasons why financial development may instigate an increase in the aggregate volume of real savings is the direct institutional effect. This implies that saving is "institution elastic", and the existence of financial institutions may promote high marginal propensities to save. Furthermore, development of financial markets and the multiplication of financial institutions are expected to affect the form of savings and mix of deposits.

It is therefore necessary to examine the growth of branch network of commercial banks in Nigeria because it gives a snapshot of the physical structure of the commercial banking system and the scope for effective mobilization of savings. Nigeria operates a nationwide branch banking system as opposed to unit banking system, and there is no law limiting the branching of commercial banks within and among the nineteen states. There has been a remarkable increase in recent years in the number of branch bank offices in the country. As Table 1 indicates there were only 190 bank offices owned by 12 banks in 1960. By 1964, the number of banks and branch offices rose to 17 and 11, respectively. There are a wide range of saving institutions that can be developed... Experience shows that the amount of savings depend partly on how widespread these facilities are; it may be pushed right under the individual's nose. If the extent of having saving groups, or saving clubs, or even deductions from earnings at source, people save more than if the nearest saving institution is some distance away. W.A. Lewis, The Theory of Economic Growth, New York: Praeger, 1970.


14 For example, Weisbrod found that the convenience of branch banking permits customers to hold lower balances in non-interest bearing demand accounts and correspondingly hold higher balances in less liquid high yielding assets. S.R. Weisbrod, The Convenience Bias in Branch Banking and Economics of Scale. Federal Reserve Bank of New York, Research Paper No. 8013, 1980.
226 respectively. By 1958, the number of banks declined to 13 but the branch offices increased to 20. There were 20 banks with 748 branch offices in 1965. In the last budget speech the president of Nigeria, Alhaji Shehu Shagari, stated that the government has granted licenses to five new banks and approval has also been given to 91 new offices which will start operations as soon as they have complied with the laid down conditions. He further stated that 48 new branch offices have been opened bringing the total number of branches to 917. The growth rate of bank offices has varied per annum using the 1983 census figures. 

Note: The population is projected at 256 per cent of the 1973 census figure.

been positive over the period 1960-80, with the highest rate of 15.2 per cent being recorded in 1965. This encouraging increase in bank offices was due to the first phase of Rural Banking Scheme which lasted for the period 1970-80. By the end of December 1980, for instance, a total of 200 bank offices have been established, and out of the 917 bank offices by November 1982, 273 were located in the rural areas, all of which were opened under the Government rural Banking Scheme.

Apart from the period 1950-64 the average branch office per bank has been increasing, rising from 16 in 1965 to about 35 in 1970 and in 1975 it stood at about 25. It was 37 branch offices per bank in 1980.

In relation to the size and population of Nigeria, however, there is still the inadequacy of banking facilities in Nigeria. The tremendous growth in bank offices has enhanced the savings mobilization scope of the commercial banks. However, despite this great increase in recent years, Nigeria still remains under-banked with a ratio of one bank office to 114,503 persons in 1960. This does not compare favourably with the density of bank offices in other countries such as the United Kingdom with a ratio of 1:40,000, the US with 1:6,000 and, a ratio of 1:15,000 in India.

The implications of the low bank density is clear. First, a lot of savings are not being mobilized, and thus a lot of savings remain idle or dissipated owing to lack of institutions to mobilize them. Second, Nigeria has still a long way to go in habituating the people to modern banking. Third, the death rate of bank offices, particularly in the rural areas, has given impetus to the flourishing informal money markets of much misgivings merchants and money lenders with their usurious interest rates. There is, therefore, great prospects for the commercial banks in their savings mobilization and resource allocation role in the economy.

Another limitation to savings mobilization and resource allocation as a consequence of defective banking structure is the fact that the concentration of banks and their offices are biased in favour of urban areas. The reasons for this are simple but unfortunate. First the major urban centers provide the easy basis and sources of commercial banking business and profitability so that banks follow business instead of leading business. Financial institutions must be created in anticipation of needs for credit and as an instrument of development in an economy like Nigeria, instead of waiting on the

17 D.R. Postbanken and K.J. Steinød, “Multimurpose bankcop: its nature, scope and relevance for less developed countries”, op. cit.
The role of commercial banks in Nigeria

C.C. Agu - THE ROLE OF COMMERCIAL BANKS IN NIGERIA

...demand and supply. Second, the established banks erroneously underestimate the volume of savings seeking to be mobilized and channelled into productive investment in the rural areas. It is often argued that since the rural economy operates at or near subsistence level, there is very little that can be squeezed out of incomes and consumption. Because of this, it has not been realized that large volumes of idle funds, though in small units per individual, exist in the rural areas. The fact is that these reserves of productivity do exist somewhere in the rural areas, the primary problem of development is to gather them and utilize them efficiently. This is why the rural banking programme is a welcome policy. The volume of financial resources of many institutional credit societies in many developing countries supports this measure. Finally the commercial banking system was until recently dominated by foreign banks which tended to establish their branches where there is a concentration of exploitative businesses of few urban merchants and traders.

3.2. Degree of financial intermediation

The development of the commercial banking system and indeed the financial system as a whole and the degree of financial intermediation in a country can be measured in a number of ways. One generally acceptable measure is the financial interrelations ratio (FIR) defined as the ratio of market value of all financial claims outstanding to national wealth, that is, physical assets plus the net foreign balance. Another measure is the ratio of financial instruments issued by the financial institutions to those issued by non-financial units which indicates the degree of institutionalization of savings. These measures, their shortcomings notwithstanding, are not meaningfully applicable to the Nigerian situation. The FIR, for example, assumes the existence of a detailed account not only of financial assets held, but also of national wealth - tangible assets plus net foreign balance. Similarly the measure of new issues of financial instruments relative to those of other economic units assumes the existence of a flow-of-fund accounts. This indicator is of limited use in economies where the banking system's closest competitors are informal money markets where reliable data and information of new and old debts are impossible.

In this study we adopt a slight modification of CIR. We assume that national output, measured as the national wealth and measured financial intermediation by the use of the consolidated assets in commercial banks to national output (GDP). Since assets of the commercial banks constitute the bulk of the assets of the financial intermediaries, the ratio of commercial banks' assets to national output is used as a measure of the extent of financial deepening in Nigeria. This measure is supplemented by the ratios of demand deposits to money supply and time plus savings deposits to money supply. This is the easier way to gauge the extent of the diversification of commercial banks' primary deposits.

Table 2 shows the commercial banks' asset/GDP ratio, the ratio of demand deposits to money supply and the ratio of time and savings deposits to money supply. Money supply is here narrowly defined as the currency outstanding plus demand deposits. It is interesting to note that the ratio of commercial banks' assets to GDP has increased considerably in recent years. It rose from 9.8 per cent in 1960 to 27.3 per cent in 1981. The highest proportion of 31.7 per cent was recorded in 1978. Overall, the growth of financial assets of commercial banks outpaced production. The long-run growth trend in the ratio reflects the important role of commercial banks and their financial technology in the savings mobilization and thereby in the development of the economy.

The ratio of demand deposits to money supply increased from 34.2 per cent in 1960 to 55.1 per cent in 1965, and after a period of fluctuating trend (1965-73), it recorded 55.8 per cent in 1974 and 58.1 per cent in 1979. Since money supply is here narrowly defined to embrace only currency in the hands of the non-bank public and demand deposits with commercial banks, a high ratio of demand deposits to money supply indicates the greater use of bank money than of currency. This is indicative also of increased banking habit and thereby greater scope for savings mobilization by the commercial banks. The proportion of savings and time deposits to money supply for the same period has risen considerably from 22.8 per cent in 1960 to 65.9 per cent in 1970 to 68.8 per cent in 1970 and then to 68.8 per cent in 1981. The annual average of the ratio of the demand deposits to money supply and the savings plus time deposits to money supply were 46 per cent and 51.5 per cent respectively. Both ratios imply a moderately high degree of financial intermediation.

Another basic measure of the performance of the commercial banks is the level of the growth of total deposits per capita. The information is an indication of increased capture of financial resources by commercial banks which is related to the more advanced stage of banking development. Table 2 further shows that total commercial banks' deposits per capita rose 30.7 times the 1963 level in 1980, increasing from 3.4 million in 1963 to 187.2 million in 1981. The long-run growth trend

Table II

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Fixed Capital Formation</th>
<th>Contributable Capital</th>
<th>Annual changes in Bank credit to the Economy</th>
<th>Annual changes in Bank credit to the Economy as % of Gross fixed capital formation</th>
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<tbody>
<tr>
<td>1963</td>
<td>525.0</td>
<td>125.4</td>
<td>-</td>
<td>23.2</td>
</tr>
<tr>
<td>1964</td>
<td>543.0</td>
<td>125.4</td>
<td>-</td>
<td>12.7</td>
</tr>
<tr>
<td>1965</td>
<td>563.0</td>
<td>125.4</td>
<td>-</td>
<td>10.7</td>
</tr>
<tr>
<td>1966</td>
<td>583.0</td>
<td>125.4</td>
<td>-</td>
<td>9.0</td>
</tr>
<tr>
<td>1967</td>
<td>603.0</td>
<td>125.4</td>
<td>-</td>
<td>8.8</td>
</tr>
<tr>
<td>1968</td>
<td>623.0</td>
<td>125.4</td>
<td>-</td>
<td>8.8</td>
</tr>
<tr>
<td>1969</td>
<td>643.0</td>
<td>125.4</td>
<td>-</td>
<td>8.8</td>
</tr>
<tr>
<td>1970</td>
<td>663.0</td>
<td>125.4</td>
<td>-</td>
<td>8.8</td>
</tr>
<tr>
<td>1971</td>
<td>683.0</td>
<td>125.4</td>
<td>-</td>
<td>8.8</td>
</tr>
</tbody>
</table>

In total deposit per capita implies that as economic development proceeds, the community chooses different ways of allocating its available funds primarily on the basis of services offered by the commercial banks. For this reason it could be argued that individuals in the economy are increasingly becoming aware of the new and better banking services, safety of deposits and facility of their use among other factors.

The next important basic question that should be dealt with here is whether or not the commercial banks have contributed to higher rates of investment in the economy. A simple definition of the contribution of commercial banks to the financing of capital formation consists of the calculation of increases in banks' credit to the private and
public sector as a percentage of gross domestic investment. The calculations are shown in Table 3. Although this coefficient of mobilization of resources by commercial banks can overstate the contributions of commercial banks to investment because part of the credit is allocated to investment and part to consumption expenditures, it is nonetheless regarded as a satisfactory indicator of that contribution. The Table shows that the coefficient of mobilization of resources by commercial banks increased from an annual average of 12.3 per cent in 1964-66 to 20.9 per cent in 1967-70. The coefficient declined drastically to an annual average of 8.3 per cent in the period 1971-75. It rose again in 1976-80 to an annual average of 13.7 per cent. For the entire period 1966-80 this coefficient averaged 13.6 per cent. One interesting observation in the hand of this coefficient is that despite the sustained expansion of bank credit as a percentage of investment, alternative sources of investment financing continued to be dominant. Indeed such financing still depends heavily on internal savings of firms and to a lesser degree on the sale of debt instruments and shares in the financial markets.

3.3. Financial repression effects

Another factor that affects and constitutes a great problem to savings mobilization and resource allocation by commercial banks is financial repression. According to the proponents of the financial repression hypothesis, the sources of repression are government legislation policies such as legal restrictions on activities and interest rate policies that distort the full operation of the market mechanism in fixing prices for financial resources. Since according to them the repression show their effects on limited savings generated because of interest rate ceilings on deposits, limited loan resources because of loan rate ceilings, the hypothesis is ultimately reducible to interest rate policies. It is, however, recognised that other forms of financial repression might result from other factors, such as portfolio regulations and oligopolistic financial markets. 25

Interest rates in Nigeria are institutionally determined and administered. Consequently, interest rates are not a good indicator of the abundance or scarcity of capital in the economy. Interest rates have thus been maintained at a very low and static level over the years for various reasons: first, to enable the government borrow from the public at a very cheap price. A second reason that has been used to justify the policy of low and static interest rates regardless of economic circumstances in the Keynesian postulate that a low interest rate implies a high rate of investment. This justification is based on a misinterpretation of Keynesian investment theory which is not necessarily applicable under full employment with inflation. There are other less plausible reasons of low interest rates policy. There is the argument that low and stable interest rates can help strengthen the stability of the financial institutions because low interest rates on their liabilities help to protect their earnings; there is also the influence of the well known usury law which limits the payment of interest on moral grounds.

Table 4 shows the interest rate structure in the economy. A cursory look at the Table reveals the static nature of the interest rate over a period. For instance, for five years, 1970-74, interest rates on savings deposits remained low and static at 3 per cent. It rose marginally in 1975 to 4 per cent and remained the same till 1978. The same is true of the time deposit rates and the minimum rediscount rate - the CBN minimum lending rate. There would have been nothing worrying about the static and low interest rates, it the rate of inflation had been stable over the years. But it was not. Inflation has become a thing worrying about the static and low interest rates, if the rate of inflation had been stable over the years. But it was not. Inflation has become a
permanent feature of the Nigerian economy: since 1970, for instance, the average consumer price index was 52.8 (1975 = 100). For 1991 it was 263.9. The increase in the index over 12 years was thus 269.1 per cent or an average annual rate of increase of 16.1 per cent. Consequently, there is bound to be an adverse effect of inflation on the real rate of return on savings with return declining with high rate of inflation.

Table 4

<table>
<thead>
<tr>
<th>Interest Rate Structure 1970-80</th>
<th>(percent)</th>
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<tbody>
<tr>
<td>Year</td>
<td>Minimum Rate</td>
</tr>
<tr>
<td>------------------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>1970</td>
<td>4.8</td>
</tr>
<tr>
<td>1971</td>
<td>4.5</td>
</tr>
<tr>
<td>1972</td>
<td>4.5</td>
</tr>
<tr>
<td>1973</td>
<td>4.5</td>
</tr>
<tr>
<td>1974</td>
<td>4.5</td>
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<tr>
<td>1975</td>
<td>4.5</td>
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<td>1976</td>
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<td>1977</td>
<td>4.5</td>
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<td>1978</td>
<td>4.5</td>
</tr>
<tr>
<td>1979</td>
<td>4.5</td>
</tr>
<tr>
<td>1980</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Table 5 shows rates of inflation and the real rates of return on time and savings deposits with the commercial banks. It is shown that the real return on over 12 months time deposits was negative for the entire period 1970-80 except in 1972 and 1980 when a positive return of only 1.4 per cent and 0.2 per cent respectively were recorded. Real rate of return on savings deposits was positive only in 1972 and negative for the rest of the period. It is thus clear that there is a great measure of financial repression and it has been contended that the level of financial repression.

148
through negative real interest rates pose important microeconomic questions concerning an economy's ability to accumulate financial assets in real terms, the volume of national savings and domestic investment, the efficiency of investment and the allocation of resources. It has thus been argued that one reason for the reluctance of savers to use banking institutions is that they offer relatively lower returns.

A more general framework for testing the hypothesis of financial repression is offered by the concept of the real demand for financial assets held by the public. In this framework, financial repression is the decrease in the real rate of interest. McKinnon postulated the following model:

Table 5

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in Consumer Price Index 1970-90 (%)</th>
<th>Nominal Interest Rate on Over 12 Months Savings Deposits (%)</th>
<th>Real Interest Rate on 12 Months Savings Deposits (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>2.0</td>
<td>5.0</td>
<td>- 3.0</td>
</tr>
<tr>
<td>1971</td>
<td>2.6</td>
<td>5.0</td>
<td>- 2.4</td>
</tr>
<tr>
<td>1972</td>
<td>2.0</td>
<td>5.0</td>
<td>- 3.0</td>
</tr>
<tr>
<td>1973</td>
<td>2.0</td>
<td>5.0</td>
<td>- 3.0</td>
</tr>
<tr>
<td>1974</td>
<td>2.0</td>
<td>5.0</td>
<td>- 3.0</td>
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<tr>
<td>1975</td>
<td>2.0</td>
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<td>1976</td>
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<td>1977</td>
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<td>1979</td>
<td>2.0</td>
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</tr>
<tr>
<td>1980</td>
<td>2.0</td>
<td>5.0</td>
<td>- 3.0</td>
</tr>
</tbody>
</table>

Note: *The real rate of interest is defined as the nominal rate of interest adjusted by the change in the consumer price index. The real rate is equal to \( r + \frac{a}{1 + p} \), where \( r \) is the nominal interest rate and \( p \) is the change in prices during the year.

Sources: Derived from Table 4.


150
The role of commercial banks in Nigeria

\[ (\text{MP})^2 = f(\text{Y}, \alpha \text{r} \text{P}) \]  

where
\[ (\text{MP})^2 = \text{the demand for financial assets by the public in real terms.} \]
\[ \text{Y} = \text{the real GDP.} \]
\[ \text{r} = \text{the average rate of return to capital} \]
\[ \alpha \text{P} = \text{the expected real rate of interest}. \]

All the explanatory variables have a positive effect on real demand for financial assets under repression.

In testing the hypothesis in the Nigerian commercial banking system we use a modified version of the model:

\[ \text{MP} = f(\text{Y}, \text{P} \text{Pt}-1) \]

where
\[ \text{Y} = \text{the GDP at current market prices} \]
\[ \text{P} \text{Pt}-1 = \text{the rate of inflation and represents the} \]

opportunity cost of holding money relative to alternative real or financial assets. We ignored the inclusion of the interest rates variables because as noted above the rates have been more or less static over the period. The test is to determine whether the demand for money over a period of time is inflation elastic or not. The inflation inelasticity of the demand for money may be evidence of financial repression. The two determinants \text{Y} and \text{P} \text{Pt}-1 are expected to have positive and negative impacts respectively on the real demand for money. Both the narrow definition of money (\text{M}_0) and the broad definition of money (\text{M}_2) minus time and savings deposits --- have been used in the analysis. Annual data for the period 1960-80 were used.

It is common practice in the literature to take the logarithm of equation (2) and since this suits our analysis because it enables the interpretation at the coefficients as elasticities, the logarithm form of equation (2) yields:

\[ \ln \text{MP} = \ln \text{a}_0 + \text{a}_1 \ln \text{Y} + \text{a}_2 \ln \text{P} \text{Pt}-1 + \text{a}_3 \ln \text{t}. \]

In \text{M}_0 \text{P} = \ln \text{b}_0 + \text{b}_1 \ln \text{Y} + \text{b}_2 \ln \text{P} \text{Pt}-1 + \text{b}_3 \ln \text{t}. \]

where the \text{b}_x become the various elasticities and the \text{u}_x the error term.
The test results are presented here:

\[ \ln \frac{M_1^p}{P} = 2.3449 + 0.5358 \ln Y + 1.0061 \frac{R}{t-1} \]

\[ \ln \frac{M_2^p}{P} = 2.4732 + 0.5941 \ln Y + 1.1261 \frac{R}{P+t-1} \]

\[ R^2 = 0.964 \]
\[ d.w. = 2.1 \]
\[ R^2 = 0.963 \]
\[ d.w. = 1.6 \]

Below each coefficient is the standard error, statistically significant at 1 per cent level.

From the test results above it is seen that a considerable proportion of the dependent variable is explained by the explanatory variables. The Durbin-Watson statistics (d.w.) of 2.1 and 1.6 for the estimates of equations (3) and (4) respectively indicate the absence of first order positive and negative autocorollarity in the data used for the regression analysis. All the coefficients are statistically significant at less than 0.01 probability.

Of particular interest is \( a_{12} \) and \( a_{30} \), the inflation elasticity of demand for money. The coefficients have theoretically unexpected sign, indicating that increases in the rate of inflation leads to increases in the demand for money. This ignores the opportunity cost of holding money. The explanation that may, perhaps, be offered for this is that because of the future expectation of further inflationary pressures people hold more money particularly when there were no alternative assets that can serve as a hedge against inflation.

More importantly, the coefficients of \( a_{12} \) and \( a_{30} \) indicate elasticities of 1.01 and 1.13 respectively. This implies that the narrow and broad definitions of money — \( M_1 \) and \( M_2 \) — respectively are inflation elastic. The finding, therefore, rejects the hypothesis of financial repression in Nigeria. However, as Kwarteng in a similar analysis contends, the inflation elasticity of demand for money in Nigeria may be due not so much to the non-existence of financial repression in the Nigerian economy, in fact there is some evidence of financial repression in Nigeria as per the low levels of the real return on deposit, but rather to the higher increases in export revenues from oil and thus in income during the 1970s.

We have so far assumed that savings and investment are respectively interest elastic. The question is whether a free and positive interest rate policy advocated by the proponents of the financial repression hypothesis would lead to higher savings and investment than hitherto in Nigeria. Admittedly, the policy whereby commercial banks pay very low interest rates of about 4 per cent on fixed-bearing deposits and at the same time charge as high as 7-11 per cent on their loans and advances is discouraging enough to savers. It is likely to have a negative effect on the performance of the commercial banks’ saving mobilization and resource allocation role.

An examination of Table 4, however, shows that saving is interest inelastic. For example from 1970 to 1974 interest rate remained static at 3 per cent and for the period 1975-78 it was also static at 4 per cent, rising marginally to 5 per cent in 1979-80. Over the same period, savings index continued to rise steadily with spectacular increase of 61.9 per cent in 1975 of 1974 level. An explanation usually offered by bankers for this is that the small savers do not undertake saving with an objective of earning interest income but rather as mere safe custody for an unexpected contingency. As to give credence to this view Hirsch and Whealan contend that for the few under-developed countries in which it was possible to study the relationship between interest rates and savings, the net impact of real interest rate on aggregate savings was found to be insignificant or even negative, suggesting that higher rates of interest are associated, if anything, with lower real savings.

On the investment side, how far an increase in interest rate will deter investment is dependent on the expected return on investment. Take, for instance, the period 1970-74 when the return being declared by industrial and commercial enterprises in Nigeria were of the order of 100 per cent on the capital invested, first-class prime advances rates remained static at 7 per cent (see Table 4). Other advances, however, rose by 2 percentage points from 8-10 per cent. This type of increase is hardly likely to be decisive in the investors’ plans and decisions to invest if the expected return will be reduced not so significantly or may not in fact, in spite of the resultant increase in costs, go up even more. It follows therefore, that what is important for Nigerian investors seeking funds in the boom conditions of 1970-76 is not so much the rate of 183

30 T. Hirsch and J. Whealan, Aspects of the Mobilization of Savings in LDCs, op. cit. See also J.G. Williamson, Personal saving in developing countries: an international cross-section from Asia, The Economic Record, June 1968.
interest but whether or not credit will be available. To corroborate this assertion Fagali further observes that the popularity of the informal money market despite the numerous rates of interest underscores the importance of availability rather than cost in determining the demand for and supply of rural credit. This explains why, as Table 4 shows, the index of loans continued to show a rising trend in spite of the rise in the produce and other advances rates in the period 1970-74. In 1978 when both rates were 11 per cent respectively, the index of loans rose 9.76 times the 1970 level when the rates were 7.75 per cent and 8 per cent for produce and other advances respectively.

4. Conclusions

Commercial banks, the most important component of the Nigerian financial system, are the most important saving mobilization and financial resource allocation institutions in Nigeria. These roles make commercial banks essentially a phenomenon of development. In performing these roles in the Nigerian economy, it was found that the banks have potential scope and prospects for mobilizing financial resources and allocating them to productive investments. These scope and prospects have to be exploited quickly by enlarging the number of bank offices and also by the banks branching into the rural areas where a lot of savings lie idle or dissipated and where productive investment projects do not take off because of lack of financial institutions to mobilize and channel the funds so mobilized into productive activities.

The analysis raises an important question: whether the assumed repressive measures are indeed repressive. This is because the proponents of the financial repression hypothesis failed to appreciate the popular financial structure of developing countries

32 O. Aigbe, Savings mobilisation in Africa, op. cit.
33 Shyam and Mahfoud emphasized these roles when they said: In essence there are main issues vital regarding the influence of financial intermediaries: first, their impact on the growth of savings, especially of the household sector; second, their role in the channelization of those savings (that is savings in a financial form); and third, their ability to ensure the swift efficient transformation of mobilized funds into real capital. See H.J. Bhushan and D.P. Krishnaswamy, Financial intermediation, savings mobilization and entrepreneurial development: the Asian experience, IFAD Staff Papers, March 1978, vol. 22, pp. 129-159.

154
such as Nigeria. As Adewummi rightly noted, the proponents of the financial repression hypothesis based their studies in advanced countries and went on to interpret the result without sufficient qualifications for the developing countries with entirely different environments. It is obvious that the environments differ not only in variety and volume of financial instruments and institutions but also in the interactions of different subsectors and sophistication of activities and operations. If it is realised that the Nigerian commercial banking system was until recently dominated by foreign banks which maintained strong oligopolistic bank market structure, it will be fully appreciated that competitive market structure does not exist in Nigeria. Consequently, interest rate management may not be regarded as substitute for the determination of interest rates by competitive market forces, but as necessary alternative when conditions for the existence of competitive market conditions are not present and cannot be readily established. In the absence of competitive market structure, positive interest rate policy could potentially destabilise financial markets, increase the power of oligopolistic financial firms to exploit market imperfections, increase the interest spreads between loan and deposit rates, and simply perpetuate the existence of a financial environment with rather low deposit rates of interest. To establish an adequate level and structure of interest rates in this peculiar situation, there is need for government intervention to aid the market.

Thus while financial repression through interest rates ceiling may discourage savings in Nigeria it is not as serious as has been postulated by the apostles of the financial repression hypothesis. The commercial banks should nevertheless offer simple, intelligible and convenient financial instruments yielding a positive real return. Even if low, real interest rates on deposits should encourage savings mobilization by the commercial banks. It is, however, recognised that while the increase in the number of bank offices and variety of financial instruments are important for savings mobilization and resource allocation, the adoption of appropriate policies by the monetary authorities is essential.
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LE RÔLE DES BANQUES COMMERCIALES DANS LE PROCESSUS DE MOBILISATION ET D'ALLOCATION DES RÉSSOURCES POUR LE DÉVELOPPEMENT AU NIGERIA

Les banques commerciales, composantes fondamentales du système financier au Nigeria, sont les établissements les plus importants qui favorisent et mobilisent l'épargne vers des investissements productifs. Cela, à cause de la présence d'un ensemble de bureaux et de succursales, et du fait que le passif des banques, faisant partie de l'offre de monnaie, est très liquide et attrayant pour les épargnants. Pour ce rôle important, les banques commerciales sont essentielles au phénomène de développement. Le rôle joué par les banques commerciales dans la mobilisation et la canalisation de l'épargne financière dans l'économie de la Nigéria a été limité par deux facteurs impor-
tente 1) la faible densité des bureaux appartenant aux banques commerciales; une vaste partie du système économique et en particulier les zones rurales étaient encore dépourvues de services bancaires. Dans le pays la densité bancaire est faible (on compte un bureau pour 114,503 personnes). Cela entraîne par conséquent des habitants bancaires peu répandus, de faibles taux d'épargne et de canalisation des ressources par les banques commerciales. 2) La répression financière. A cause de l'absence d'une politique active des taux d'intérêt, les taux d'intérêt étaient négatifs et probablement ont défavorisé la mobilisation de l'épargne des banques commerciales. Toutefois, tandis que la politic de libéralisation du taux d'intérêt peut devenir nécessaire pour rendre positifs les taux d'intérêt réels, la politique de libéralisation de la structure des taux d'intérêt est contredite à cause de l'absence de conditions compétitives dans le système bancaire. Cette politique pourrait conduire à une plus faible mobilisation de l'épargne pouvant destabiliser les marchés financiers et augmenter le pouvoir des entreprises financières en forme d'oligopoles. Ces dernières pourraient tirer parti de cette situation et pratiquer des imperfections sur les taux d'intérêt.

Le but des banques commerciales dans la mobilisation de l'épargne pourrait être plus facilement atteint en augmentant le nombre de leurs filiales en particulier dans les zones rurales et en faisant adopter des politiques épargnées aux autorités monétaires. Ces politiques pourraient être envisagées de façons différentes soit, en permettant la libéralisation de tous les taux d'intérêt soit, en établissant une politique disproportionnelle des taux d'intérêt. Le choix, toutefois, devrait être subordonné à l'orientation générale de la politique économique du pays. Il faut se rappeler que, à cause de la nature spécifique de l'économie et du système des banques commerciales, l'intervention du pouvoir public est encore nécessaire dans le système bancaire pour aider les forces du marché à établir un niveau adéquat des taux d'intérêt.
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