Global Financial Crisis and Financial Sector Development in Nigeria

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Abstract

Globalization generally has been conceptualized as increasing integration or interaction of national economic system through growth in international trade, investment and capital flows; thereby leading to economic growth. The rapid spread of the currency and stock market crisis from one country to another has been due to contagion effects, where the occurrence of the crisis in one country increases the probability of a similar crisis in another country. The financial crisis of the East Asian of 1997 and the Mexican peso crisis of 1994, and Argentina, 2001 are observed as the two contagion effects in the recent past. For the finance linkage, a financial crisis in one country may involve investors to reduce asset holdings in other countries (even if these other countries were not initially affected); if the investors expect positive correlation in asset returns across these countries. The dramatic fall in communication and computing costs over the past three decades, attempts to maintain barriers between national and global financial markets. Technological determination may help explain the broad trends towards financial liberalization since the 1970s. About six developing system in the world in 2000, with aggregate deposit share of about 6 percent of about 108 developing countries studied,80 had total bank deposits of less than $10 billion of which 42 had less than $1 billion. The tiny sizes of their financial systems reflect the size of their GDP. In 2000, it was found that the bank fund staff federal credit union (a bank for the staff of the IMF and the World Bank) had a balance sheet size target than those of banks in 60 poor countries put together. In Asia, Latin America, and Africa, regionalism is top of the agenda albeit with varying speeds and successes. Some countries managed to sustain rapid growth with just modest reforms, while others could not grow after implementation of a wide range of economic reforms in their economies. Moreover, similar economic reforms yielded vastly different responses. The main areas of concern where policy institutional change during the 1990s and 2005; Macroeconomic stabilization, trade liberalization, financial sector reforms, privatization and deregulation, public sector reform, democratization and it combined an analytical review of growth episodes with the views of practitioners, policy makers who had been in charge of implementing significant policy and institutional reforms during the 1990s.

Key words: Financial Crisis, Financial System, IT, Globalization, Economic Development, Economic Growth, Technology, Financial Openness, International Trade, Labour Flows, FDI, and Technical Change.

1. Introduction

Globalization generally has been conceptualized as increasing integration or interaction of national economic system through growth in international trade, investment and capital flows; thereby leading to economic growth. Husain (2000) in Nwokoma (2004) emphasized that globalization leads to international trade, financial integration, international labour flows, technical change and economic growth.

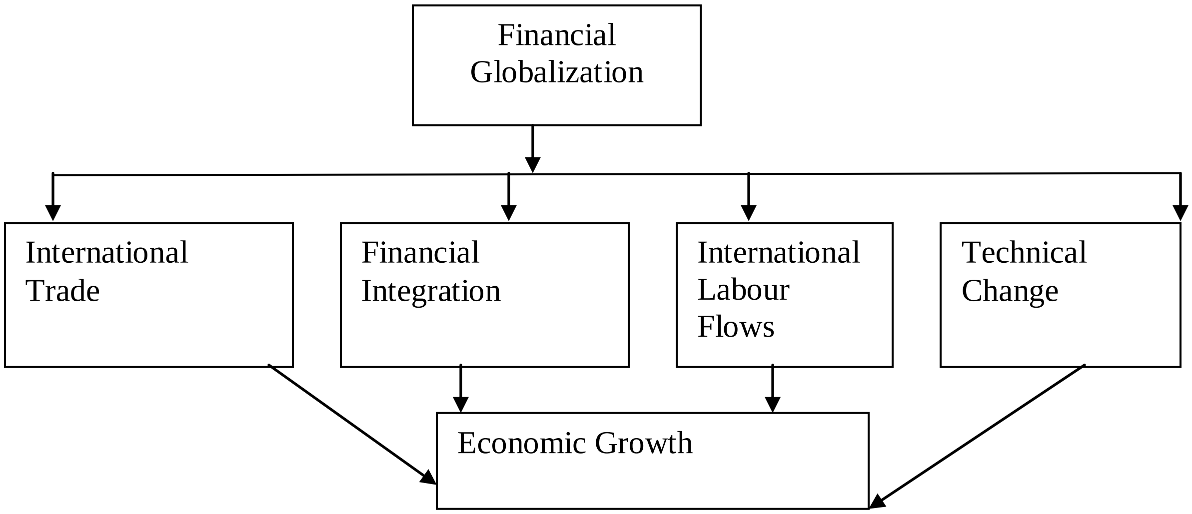


Fig. 1 Financial Globalization – source: Adopted from, Husain (2000) and Nwokoma (2004) pp 486.

Gounder and Sen (2000) has reported that the rapid spread of the currency and stock market crisis from one country to another has been due to contagion effects, where the occurrence of the crisis in one country increases the probability of a similar crisis in another country. Different explanations have been given as to why such contagion effect arises in the first place. One is that contagion effects arise when flows to one economy are transmitted to other economies that are linked to the first economy by trade and finance. While the second explanations is based on the premise that contagion effects are simply due to the possible irrational behaviour of agents in the financial markets who follow other investors without taking their own positions in the market. The financial crisis of the East Asian of 1997 and the Mexican peso crisis of 1994 are observed as the two contagion effects in the recent past. While, Gerlach and Smets (1994) suggest that a currency crisis in one country may lead to devaluation of currency in another country if the two countries engage in a significant amount of bilateral trade. On the other hand, Corsetti, Resente, Roubini and Tille (1998) have suggested that competitive devaluation may arise even if two countries do not directly trade with each other but compete in a common third market. For the finance linkage, a financial crisis in one country may involve investors to reduce asset holdings in other countries (even if these other countries were not initially affected); if the investors expect positive correlation in asset returns across these countries. Meanwhile, Calvo (1998) has proposed a theory of contagion effects based on herding mentality among investors that does not assume irrationality among individual agents.

While, Tobin (1998) is of the view that the integration and perfection of finance markets will bring money market interest rates in different financial centres closer and closer together. And this invariably also applies to other prices and rates in the capital market.

2. Understanding Financial Globalization: A Political Economy Framework

Financial globalization could be seen within the political economy framework, in terms of technological determinism approach, Hegemonic power approach and rationalist interest group approach.

Technological determinism approach, according to Asogwa, (2004:644) and Audu (2009) explains financial globalization as the product of technological changes that are gradually sweeping aside the barriers to the integration of financial markets. Specifically, the communications and information technology is seen as the driving factors, the dramatic fall in communication and computing costs over the past three decades, attempts to maintain barriers between national and global financial markets only serves to push such markets offshore. Technological determination may help explain the broad trends towards financial liberalization since the 1970s (see Garret, 2000 and Asogwa, 2004).

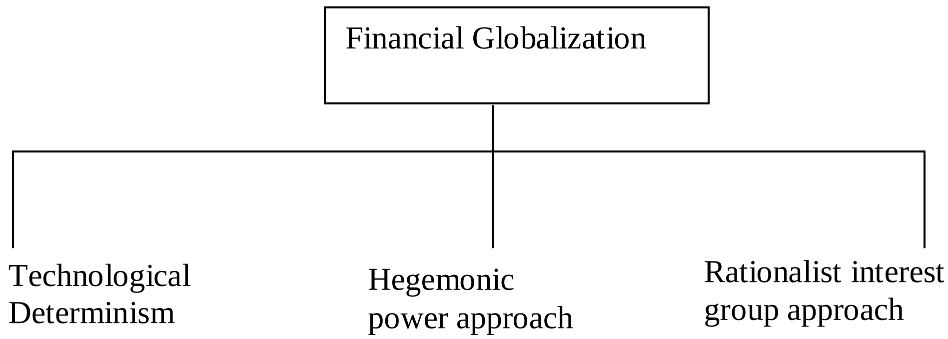


Fig 2.1 Financial Globalization as a link to technological factors

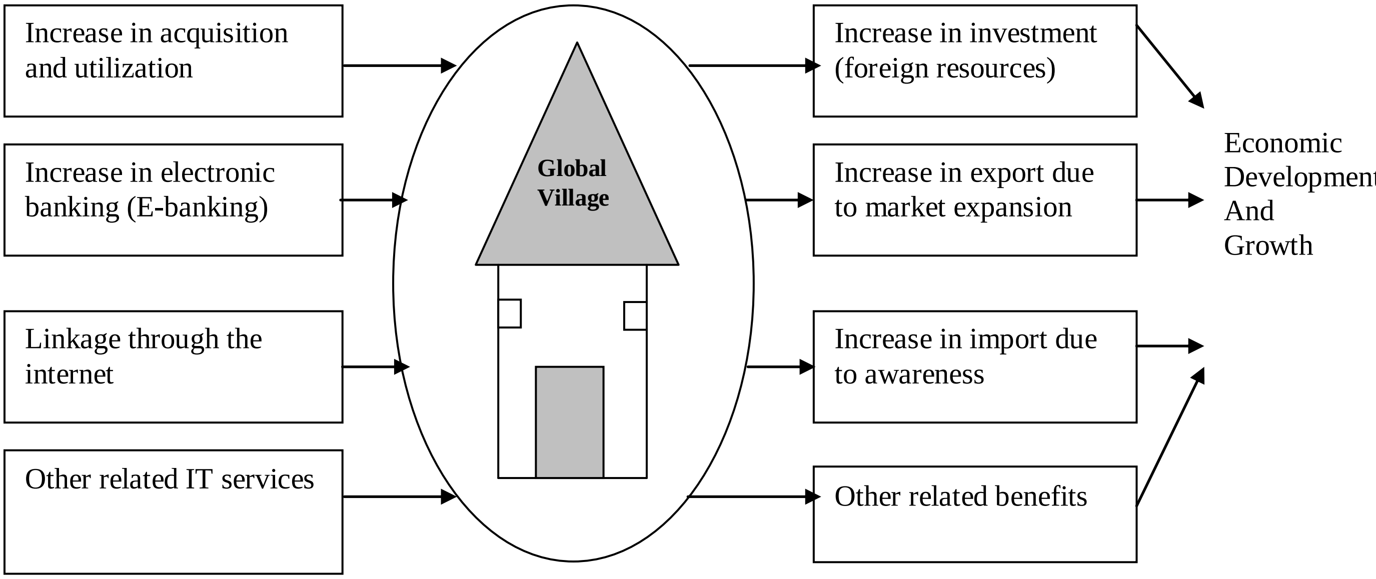
Meanwhile, in using exogenous technological factors to explain policy change, this perspective is less able to explain the differential timing of financial globalization across countries.

On the other hand, Gilpin, (1987) has argued that the hegemonic power approach that open an international financial system depends upon the existence and leadership of the liberal hegemonic power. The mechanism by which initial hegemonic power promotes financial globalization in other countries, however, varies according to different versions of the theory. Wade (1996) has argued that financial liberalization, unlike trade liberalization, can flourish with international competition rather than cooperation and perhaps one version of the theory holds that the United States of America in particular has used various multilateral and bilateral means to promote financial liberalization abroad, especially with its dominance within the World Bank and IMF.

While in effect, hegemony explanations of financial globalization usually emphasize the role of dominant powers and dominant analytical frameworks. Walter (2002) on the other hand has noted that the problem has remained unresolved. The relative importance of hegemonic coercion versus unilateral liberalization in explaining financial liberalization remains unclear

On the other hand, Frieden (1991), Frieden and Rogowski (1996), tries to discern how liberalization differently affects identifiable interest groups within the society. The rationalist interest group approach does not focus on structural forces and state policy makers but upon the preferences of key societal interest groups. Financial globalization in this respect, occurs when groups that favour globalization organize and lobby more effectively than groups that oppose it. Frieden and Rogowski (1996) argued that key interest groups such as multinational corporations (MNCs) and domestic firms seeking cheaper sources of finance have incentives to lobby governments to undertake financial globalization polices. It is further argued that in countries that rush to attract large inflows of foreign direct investment (FDI), MNC preferences for financial openness may have been an important factor in government decisions to liberalize trade and investment. This factor, it is argued, seems to have been especially important in decisions to allow global financial institutions (banks in East Asian Countries) in the early 1980s. it is also argued that, a major concern of investors, even those oriented to domestic markets, has been their freedom to transfer funds and projects, and made possible global banks. Also, financial globalization can reduce the cost of the funds and also increase credit availability for forms (See Asogwa, 2002).

Fig. 2.2 Linkage between Financial Globalization, IT and Economic Growth



Akinboyo (2004),Audu (2009) and Edame(2006b) have argued that globalization is a process of expending economic cooperation among states, and that this does not necessarily imply future breakdown of borders. When studied from an economic perspective it does even require harmonization or integration of the social and political systems. Indeed, it could strengthen and promote existing social and political systems. It is simply a process of intensified and broadened interdependence among nation. Globalization as a process simply creates a global market place or village that with the development on communications technology can be accessed by virtually anyone from any location. The process opens up a world of opportunities for business that links them to markets, which were hitherto unknown to them, and provides prospects for economic development and growth.

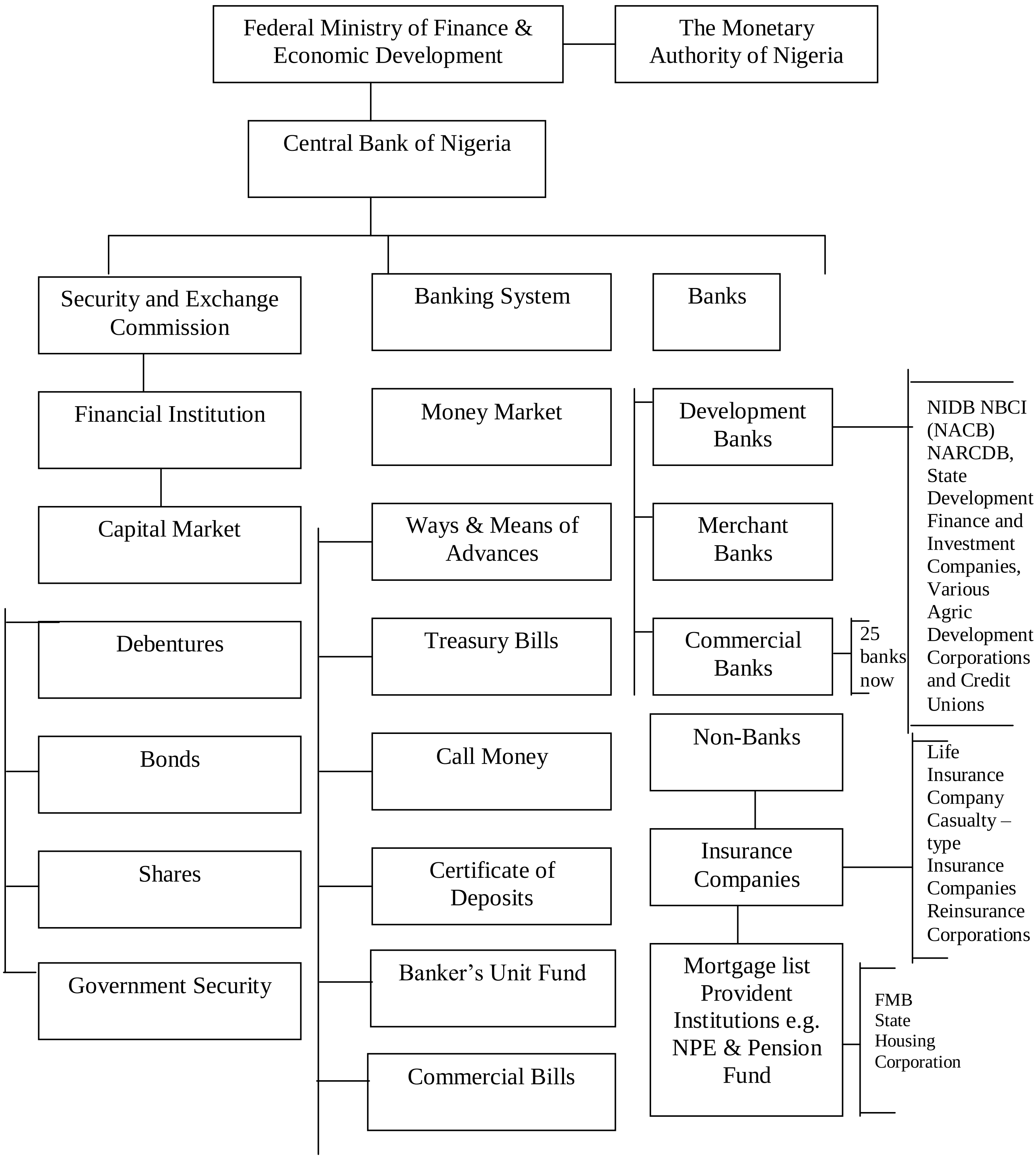
According to Akinboyo (2004:194) information technology on the other hand offers the opportunity or completely new ways of working through systems integration. Business, how ever, involves more than information.

3. The Role of Financial Globalization and Financial Sector Development in Nigeria

The financial system is conglomerate of all financial system within an economy comprising the NDIC, SEC, money and capital markets, financial institutions, the central bank as the regulation authority. The sector is dualistic with some degree of informal and semi formal financial intermediation activities simultaneously taking place (See Akinboyo, 2004 and Edame, 2006a).

Te financial system in any economy of the world plays an important role as an engine of economic development and growth. The system provides linguistic that services the needs of the economy, facilitates the mobilization of surplus fund from the surplus to the deficit sector of the economy and from the domestic and foreign sources and optimally allocates such mobilized resources to the deficit sector of the economy for productive investment. The Nigerian financial system also provides infrastructure for monetary policy transmission among other things. The Nigerian financial system or service industry in recent years has been hit by three major trends within the economy. This includes the deregulation and privatization, the introduction of new technologies and new products and the entry of new competitors. This development has led to the growth in the demand of financial services within the economy.

Fig. 3. The Nigerian Financial System



Source: Adopted from Edame, (2001[b]: 130, Edame, 2009; 33) and Akniboyo 2004:197)

The major participants in the financial services market include individuals, businesses in the real sector and those dealing in financial instruments who are uncertainty regarding the timing of their payment receipts and expenditures.

Information technology is, therefore, a strategic tool or facilitating and enhancing the emergency of a contemporary payment system in a modern financial sector whose economy is fast developing and the desire to become competitive is of economic importance.

Expenditure from Nigeria, shows that; there is a global consensus that computerization promote efficiency, competitiveness and prompt delivery of high quality products and services. In a country like Thailand for example, cheques are cleared electronically with a day through the introduction of electronic cheques system. In the quest to provide improved performance in the finance sector as an engine for economic growth, government, the monetary authorities and other actors in the financial system have intensified technology (IT) in re-engineering the Nigerian economy.

Akinboyo (2004:199) has argued that although information technology (IT) is environmental friendly, the gains associated with these technologies have not been maximized in Nigeria because of the failure to realize that IT implies more than just mere acquisition of hardware and software to substitute manual operations for automated processes. It requires technical capabilities but also a supportive environment, effective planning and organizational skills. Meanwhile, despite the short coming mentioned above, the financial sector is gradually moving from annual operation to automated methods of operations. The CBN for example; has introduced the following machines in the sector:-

The implementation of a Banking Analysis System (BAS) that provides information to banks and the Nigerian Deposit Insurance Corporation (NDIC) to monitor the development and financial viability of banks; sector for world-wide inter bank financial telecommunications (SWIFT) to provide facility for international settlement;

i. The establishment of the Nigerian Inter Bank Settlement System (NIBSS) by the committee of bankers;
ii. The banking Analysis Cooperation System (BANKOS) for consideration of its accounts;
iii. Introduction of Magnetic In character Recognition (MICR) to enhance the clearing system for cheques, which takes between 3 and 4 days for local cheques and 5 to 7 days for up-country cheques. This is already in line with the commandment of the Nigerian Automated Clearing System (NACS)
iv. The implementation of satellite wide area network (WAN), which facilitates transfer of data and voice between the head office and branches al over the country.
v. Internet operations at the CBN and branches and head offices by wide area network (WAN) while the Automated Teller Machine (ATM) is being carried out by almost all the banks in the country to provide financial services to their customers. While, WEMA Bank has also installed Telephone banking (Dial serve TM) and internet banking (connect serve TM) for banks and the customers. And in the vain, Trust Bank has Trust visual where banking business can be carried out without the physical presence at the bank's premises.
vi. Finally, the introduction of Government Security System (GSS) for the allocation of treasury bills (TB) to financial institutions, within the financial sector in the country.

The financial system of developing countries are fragmented and small. As Hanson, et al (2003:4-5) in Soludo (2008:56) indicate, only about six developing system in the world in 2000, with aggregate deposit share of about 6 percent of about 108 developing countries studied,80 had total bank deposits of less than $10 billion of which 42 had less than $1 billion. The tiny sizes of their financial systems reflect the size of their GDP. In 2000, it was found that the bank fund staff federal credit union (a bank for the staff of the IMF and the World Bank) had a balance sheet size target that those of banks in 60 poor countries put together. Only very few countries have organized stock exchanges. Size is seen as a binding constraint for many of these countries, and only regionalism and a globalization offer them a chance of sustained growth. In Asia, Latin America, and Africa, regionalism is top of the agenda albeit with varying speeds and successes. (See Soludo, 2008:57).

Financial crisis rocked Mexico (1994), and Argentina (2001). Some countries managed to sustain rapid growth with just modest reforms, while others could not grow after implementation of a wide range of economic reforms in their economic. Moreover, similar economic reforms yielded vastly different responses.

The interpretations and the wide variations and in order to draw lessons for the future was the central bank task for 2005 World Bank study economic growth in the 1990s: earning for a decade of reforms.

The main areas of concern where policy institutional change during the 1990s; Macroeconomic stabilization, trade liberalization, financial sector reforms privatization and deregulation, public sector reform, and democratization and it combined an analytical review of growth episodes with the views of practitioners policy markers who had been in charge of implementing significant policy and institutional reforms during the 1990s. What were the lessons in the 1990s? The main issues of the 1990s on economic growth was rediscovering the complexity of economic growth, recognizing that it is not amenable to simple formulas, while another result was the degree of convergence of views. Even though the practitioners, senior bank operational staff of the World Bank, and economist started from different perspectives, they all came up with remarkable similar lessons as discussed below.

1. The reforms of the 1990s focused on the efficient use of resources, not on the expansion of capacity and growth. They enabled better use of existing capacity, thereby establishing the basis for sustained long run growth, but did not provide sufficient incentives for expending that capacity. In the early 1990s in Brail, trade reforms were designed to strengthen competition and improve the efficiency of resources, use rather than to expand domestic capacity or exports. The reforms were therefore introduced rapidly, without much concern for the competitiveness of the exchange rate and the response of the manufacturing sector. The exchange rate was kept competitive to ensure export growth. Similarly, anti-inflationary policies in China during the 1990s were introduced, in a manner that minimized output losses. Thus, where as reforms can help achieve efficiency gains, they will not put the economy on a sustained growth path unless they also strengthen production incentives and address market or government failures that under cut efforts to accumulate capital and boast productivity.
2. Stabilization and macroeconomic management need to be growth oriented. The reforms of the 1990s made us to realize that how macroeconomic stability is achieve matters for growth process. Lowering inflation on the basis of appreciating nominal exchange rates stunts export and thus GDP growth. Also does reducing fiscal deficits through declines in higher return public or lowering domestic interest rates through excessive (often short-term) external borrowing. The decade also shows that the gains expected from capital account liberalization were unrealistically high and the risks under restricted the danger was not so much financial flows moving out during normal times, but inflows that eventually destabilized the economy. Most of the major recipients of private capital flows during he 1990 suffered a financial crisis, exceptions are Chile, China, and India, all of which had introduced restriction in financial inflows and had not completing opened their capital accounts.
3. Macroeconomics policies that reduce the risk and frequency of financial crisis for sustaining long-term growth would be required. What differentiate successful countries (that is, those that reduce their per capita GDP gap with industrial economies) from unsuccessful ones (those that do not) is the ability to reduce the volatility of growth which in turn reflects decisive responses to shocks and macroeconomic policies that reduced vulnerabilities and hence, the costs of shocks. Developing countries experience a fear of negative per capita growth roughly once every three years whereas in East Asia, the average is one-half that rate and in the OECD countries, one-third that rate. Korea has had only three years of negative per capita growth since 1961. Korea's ability to avoid downturns and periods of low growth partly resulting from macroeconomic policies that reduced the probability of shocks explains much of the East Asian "miracle" (see Robert Zagha, G. Nankani and I.Gill, 2006:7-11).

4. Policy Responds to Financial Crisis and Conclusion

The major issue on financial crisis seems to have caught policy makers, and on how to solve the problems. During the great depression, the classical economists believed the economy would automatically return to equilibrium (self-correct), Keynes (1924) later advised otherwise. The UK and the USA have had bank crisis in the past, that policy maker ad practitioners around the world be moaned the "global credit crunch", but some how hoped that the market would self-correct.

As the roof of the US began to come down and the contagion spread quickly to many other countries including the developing countries, the major central banks coordinated an unprecedented liquidity injection as well as cutting of interest rates to ease the 'liquidity and credit crunch'. Financial system stability became the primary goal of the central banks and price stability looks a temporary backstage in the central banks lexicon.

Recapitalization of banks with public fund along side nationalization of most industrial economies became the order of the day. The world has literally thrown everything at this crisis and policy makers seemed to be surprised at every stage that what they believed was 'the solution' was greeted with even greater pessimism by the markets.

In Nigeria for instance, the banking sector revolution in 2004-2006 under the Prof. Soludo regime as the Governor of the central bank of Nigeria, was greeted with a massive resistance by the politicians and vested interests ostensibly because it was difficult for them to see the imminent (although at the time till 'probable;) crisis or to fully anticipate the counterfactual of what would have happened if the reforms were not carried out.

Stiglitz, et at (2006:83) in Soludo (2008:53) believe that there are varieties of ways that governments and monetary authorities can nudge banks to lend in such circumstances:- Thy can for instance tax excess reserves or impose taxes on capital, gains from currency changes to discourage banks from, in effect, engaging in foreign exchange speculation. They can take more explicit regulatory actions such as not allowing banks to hold net foreign exchange assets (ether loans or bonds). They can go so far as to actively discourage banks from purchasing government bonds (e.g by limiting the amount of excuse resources that can be held in the form of government bonds, or by increasing the risk rating of such bonds).

According to Prof. Soludo (2008:5) 'The global market economy is at a threshold of history, and there are more questions than answers. The neo-leftist scholars and politicians are sounding triumphant, almost in an 'I told-you-so' mood. There has been many outbursts, the world over, in magazines and Daily News papers headlines, wondering whether capitalism and globalization is coming to an end. In other to underscore the resent financial crisis, Zedillo (2008:19) noted a follows:-

"Capitalism's hour of greatest triumph is at its hour of crises. The fall of the Berlin wall ended more than a century of political competition between capitalism and communism. Capitalism virtually stands alone as the only feasible way to rationally organize a modern economy. At this moment in history, no responsible nation has a choice. As a result, with varying degrees of enthusiasm, third world and former soviet nations have balanced their budgets; cut subsides, welcomed foreign investment, and dropped their tariff barriers. Unfortunately, however, their efforts have been rapid with bitter disappointment. From Russia to Venezuela, the past half-decade has been a time of economic suffering, tumbling incomes, anxiety, and resentment".

Different analysts have confused the extreme forms of market fundamentalism as being coterminous with capitalism or the defining form of a market economy. Financial globalization at the domestic policy level has complicated and severely constrained latitude for monetary policy. No two economies is said to be the same and every economy is, in a sense developing, to the extent that no economy ever reach as the end of development.

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