Impact of Government Withdrawal of Deposits from Commercial Banks in Nigeria

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Abstract

The 1989 Government funds transfer from commercial banks to the Central Bank of Nigeria (CBN) actually shook the money market but it also resulted in innovative and more efficient banking services in the country and crowned depositors as Kings. This article is an overview of the impact of Government withdrawal of deposits on commercial banking, inflation, exchange rate and money supply in the Nigerian economy. The paper used newspaper surveys for data gathering and employed percentage analyses to underscore the changes that took place in the economy. The study found that whereas inflation drastically dropped 40.9 per cent in 1989 to 7.5 per cent in 1990, it catapulted to 44.3 per cent by 1992. It was observed that money supply and exchange rate consistently remained in the upward trend with both money supply and exchange increasing nearly three-folds by 1992. The study concludes that fiscal indiscipline on the part of Government was responsible for the situation.

Keywords: Government, Banks, Deposits, Withdrawal, Reactions, Central Bank of Nigeria, Inflation, Exchange rate.

Introduction

The common stuff in any bank is money and security documents. Of course, banks don’t mint money and they do not also produce security documents for people. Rather, people deposit their money and security documents with banks. It is not only individuals that deposit their valuables with banks but also societies, institutional bodies as well as Government and its agencies. The more valuables these deposit sources may have, the more important they are perceived to be by banks. This is because any decision taken by a source in terms of the amount of deposits or otherwise has tremendous impact on banks. Banks therefore do all they could to attract and maintain deposit sources as their customers.

Bank Deposits (n.d.) states that money deposits are placed into savings accounts, checking accounts and money market accounts of a banking institution for safekeeping and the account holder has the right to withdraw any deposited funds based on the terms and conditions earlier agreed upon. Although people and institutions have right to withdraw their deposited funds, deposit money remain in the volt of banks for sometimes before being called by owners since they usually deposit surplus funds into their respective bank accounts. It is in the light of this
that banks developed various money deposit arrangements which are tied to different time frames and incentives in terms of interest payment, commission and charges for the services being rendered. Similarly, as banks realised that some depositors would not withdraw their funds until after the agreed period and sometimes event rollover the money while other people and institutions are short of funds to finance new or expand existing projects, banks began to lend money and create a borrowers’ club.

The Problem

Banks are widely believed to be rich and therefore very powerful with enormous influence because they deal with different class of people and organisations as well as store vast amount of money. Banks transfer money and information with over 90 per cent of their balance sheet consisting of loans and deposits. They assure their creditors the nominal value of the deposits plus interest due but banks cannot call back the funds from its borrowers as quickly as their creditors could do to them. When depositors decide to withdraw their funds irrespective of the terms and condition earlier agreed, the banks’ are put into chaotic situation. They do not only face the challenge of meeting up with the demand for deposit call-off and pressure of their own debtors but also the pressure to mobilise deposits from new customers. How did commercial banks react to Government withdrawal of its deposits in 1989? What motivated Government to abruptly decide to withdraw its deposits from commercial banks? What was the overall impact on the Nigerian economy?

Methodology

This study explored secondary data to examine the impact of Government monetary policy measure as it affects money circulation in the Nigerian economy. The paper made an overview of deposits withdrawal by Government and the reactions by commercial banks through newspaper surveys. Newspaper reportage was considered a useful source of data because the media provided a near live account of the Government action, its immediate impact and the responses by both corporate and individuals in the public and private sectors. Percentage changes between the base-year of 1989 and three years before and after were computed in order to observe the impact of funds transfer by Government from commercial banks to CBN in respect of inflation, exchange rate and money supply.

Literature Review

Commercial banks are basically known to play the role of credit and payment intermediations, money creation and financial service providers (What Is The Role Of Commercial Banks In Recession?, n.d.). Adebayo (2003) claims that commercial banks lend for all purposes to all and sundry, in both, wholesale and retail, within the confines of stipulated monetary guidelines. He concludes that there is a positive relationship between the amount of financial resources devoted to lending and the number of bank branches. While they create economic processes by allocating the right to use finance capital, they do not change the real ownership of funds. However, money changes hands as rapidly as possible when people and institutions have access
to it. The challenge though is that the easier it is to access money the more rapid it is dispensed with without regard to the value that may be received. This is why some economists argue that large money in circulation leads to inflation and high exchange rate.

As at the end of April 2010, there was a total of US$878.8 billion in circulation in the United States of America, two-third of which was circulating outside the country (DR Writer, 2012). The easier it was for organisations and individuals to access the dollars, it is expected that the exchange rate would be low. Conversely, the more difficult it is to get the currency to exchange, the higher the exchange rate will become. However, monetary authorities of other countries could intervene through discount rate, reserve requirements, open market operations and/or using moral suasion to tilt the exchange rate and impact on interest rate since changes in money supply affects the equilibrium for both short-term and long-term loans. This agrees with the perceptions of analysts that changes in money supply has possible effects on the price level, inflation, exchange rate and even the business cycle. It is observed however that modern central banks can now manipulate money supply which could smooth business cycle (Money Supply, n.d.).

Bhattacharya and Joshi (2000) observe that an accurate assessment of currency demand helps it to stabilise the money market in the short run and maintain the targeted monetary growth in the long run. They contend that net injection or absorption of liquidity in an economy is crucially dependent on the public’s demand for currency. However, Rupa (n.d.) argues that a central bank cannot depend purely or mechanically on forecasting models to predict currency in circulation which will be relied upon for liquidity management. He points out that unforeseen development in an economy including one-off events like Tsunami and September 11th attack in the USA could greatly influence currency circulation. He suggests close monitoring of day to day developments in order to make appropriate decisions. The floods ravaging many places in Nigeria are also a case in point. The impact does not only influence Government release of funds for purchase of relief materials and resettlement camps but it has also affected the structure of public budget and budgetary provisions in the country.

Thus, there are many factors that influence decision of monetary authorities to increase or reduce money supply in an economy. Sometimes the decision is influenced by non-compliance to monetary policy directives by commercial banks. Mishra (2012) reports that Indian authorities were to withdraw Rs. 1,000 crores from 21 banks who failed to adhere to credit-deposit ratio, priority sector lending, Kisan Credit Cards and lending to the agricultural sector. Government has decided to transfer its funds to those commercial banks that have measured up to its directive and therefore to punish those ones that did not meet the performance parameters by withdrawing its money. However, transfer of funds from one commercial bank to another only changes deposits centre, it does not reduce money supply in the economy and thus, may not affect average interest rate. Where it does, the change in interest rate will be sectoral or temporary because quantity of money in circulation has not reduced.

Whereas Rupa (n.d.) states that currency in circulation accounts for more than 65 per cent of the total reserve money in Sri Lanka, Alubankudi (2012) asserts that Nigeria has excessive
supply of currency in circulation which negates the role of money in wealth creation. On the other hand, Bayo (2011) claims that exchange rate is a major determinant of inflationary rate in Nigeria such that increase in exchange rate moderately increases inflation in the country. He argues that inflation in Nigeria is caused by increase in deficits, money supply (M1), interest rate, real exchange rate, population, trade monopoly, middleman ship, high production costs and distribution bottlenecks. He concludes that wage increase in Nigeria pushes the rate of inflation in the country while monetisation policy injects more money into circulation leading to higher inflationary rates.

Overall, liquidity of the banking system if influenced by control measures of the central bank and several autonomous factors like Government’s net borrowing from central and other banks, foreign exchange transactions, quantity of money in circulation and natural disasters which squeezes or eases liquidity in an economy.

Findings

The Structural Adjustment Programme (SAP) introduced by Government of Nigeria in 1986 was characterised by broth of policies intended to shore up the local currency (Naira), rein inflation and help spur economic growth in the country. The recipe included phasing out of the autonomous foreign exchange market and calling back foreign guaranteed loans. It was observed that large amount of money was in circulation and there was need to cut down on inflation and the continuous depreciation of the Naira. It was also alleged that banks were using Government deposits to defeat monetary policy objectives by over-lending to the economy thereby bursting credit limits.

It was noted that aggregate credit to the economy outstanding as at February 1989 stood at N57.8 billion out of which the private sector had a total credit of N31 billion outstanding while Government accounted for N26.8 billion. Of the N57.8 billion credit outstanding, the first two months of 1989 accounted for N1.2 billion credit to the economy which was about 4.2 per cent increase over the level at the end of December 1988. The 4.2 per cent credit increase also represented about 40 per cent of the annual prescribed credit target for the year or 2.4 per cent more than the average 1.8 per cent credit increase stipulated for the two months. Government therefore feared that credit to private sector could shoot up to 30 per cent by the end of December 1989 given the pace set by the first two months of the year if nothing was done to halt it.

Government also discovered that some commercial banks were granting credits to customers to purchase foreign currencies thereby putting undue pressure on the foreign exchange market. This unwarranted demand on foreign exchange pushes the exchange rate upwards which further depreciated the Naira and caused cost – push inflation in the country.

By February 1989, Governments and their MDAs had about N13 billion money deposits with the banks. It was observed that some Government functionaries kept moving Government accounts from one bank to another. It was also alleged that Government accounts were moved
by officials in order to please one or two banker friends and probably also to receive gratification.

**Government Action**

On 26th May, 1989 the Federal Ministry of Finance (FMF) issued a directive to all Government establishments including Ministries, Departments and Agencies (MDAs), State Governments and their MDAs as well as Government companies to transfer their accounts held in commercial banks to the Central Bank of Nigeria with effect from 1st June, 1989.

This action meant that the sum of N13 billion was to be moved from banks to the CBN. Large Government establishments like the Nigerian National Petroleum Corporation (NNPC), National Electric Power Authority (NEPA), Nigeria Telecommunications Limited (NITEL), Nigerian Ports Authority (NPA) and the National Fertiliser Company (NAFCON) had N2.5 billion, N1.5 billion, N800 million, N500 million and N100 million respectively money deposits with the banks. In specific terms, out of the N13 billion, United Bank for Africa (UBA), First Bank and Union Bank respectively had about N1 billion, N800 million and N1 billion Government and MDAs deposit liabilities throughout the country. Apparently, withdrawal of Government funds from the banks was a strong below-the-belt punch.

**Banks Reactions**

There was obviously no time for any systematic arrangements by banks on how to release Government deposits since there was barely one week to implement the directive to transfer its money from banks to the CBN. In the face of liquidity challenges and the lack of option to comply with the government directive, banks quickly evolved some measures.

Firstly, banks immediately stopped accepting commercial bank cheques for lodgement from Governments and their MDAs. They only decided to accept only CBN cheques issued by Governments and MDAs to contractors and civil servants for payments. This drastically reduced money outflow from banks into the economy and put most contractors and civil servants into hardship.

Secondly, banks subjected CBN cheques to clearing process instead of giving value over the counter. The CBN cheques had to stay for between four and twenty-one working days depending on where they were issued and lodged before value was received. This further tightened the money supply.

Thirdly, banks requested Governments and their MDAs to pay off their overdrafts. Those establishments that depended on bank overdrafts to finance their activities and pay after receiving subvention could no longer access funds. Many activities therefore had to be suspended.
Fourthly, where Government and MDAs had funds to transfer, such monies were moved net of any overdrafts and other receivables. This action consequently made some MDAs to be cash-trapped.

Fifthly, banks also extended their debt recovery drives to individuals and private organisations. For example, individuals who mortgaged their houses to collect loans had those properties auctioned to the public by banks in order to recover the money.

**Other Reactions by Banks**

The deposits mob-up also made banks to explore non-conventional means of generating funds and even lending targets. While banks placed restrictions on lending to businesses, some of them like First Bank granted overdrafts on salary accounts and deducted, immediately remittance were made to such overdrawn accounts.

The banks also imposed various charges on their services which hitherto government deposits withdrawals were free. In addition to Commission on Turnover (COT), banks introduced withdrawal charges of between N3 to N5 per N1,000 withdrawn, charges on personal home remittances (for foreigners), charges on bounced cheques (First Bank charged N5 for every cheque issued by its customers without sufficient funds in their accounts) and so on.

In terms of business lending, banks vigorously exploited the non-oil export drive which was backed by the Export (Incentives and Miscellaneous Provision) Act 1986 and embarked on export financing. They also encouraged export proceeds repatriation by introducing Export Proceeds Domiciliary Accounts. This measure allowed the banks to monitor export transactions and gather statistics for planning and decision making.

Many banks also expanded their branch network in order to attract more customers and mobilise deposits from the public. This resulted in aggressive marketing by banks with bankers making door-to-door visits to business premises and big individuals homes for new accounts. Bankers were offered cash incentives and promotion for winning big time depositors to their banks.

Apart from the introduction of new service concepts such as “Cash Point” e.g. UBA Cards, UNI cards, First cash, banks also introduced service schemes like Hajj Saving Scheme, House Saving Scheme, Educational Endowment Fund, etc.

Other survival strategies by banks included weekend operations, diversification into real estate business, merchant banking services, Bureau de Change as well as life and non-life insurance services. Whereas First Bank provided advances of US$50,000 to customer who placed N2 million and above for foreign exchange allocation, Bank of the North (BON) ventured into property business, many banks encouraged their employees to insure with bank’s own insurance subsidiaries.
Finally, banks cut down on their operational costs by drastically reducing expenses on overtime, medical, newspapers, coffee, etc. They also embraced the strategy of ‘collaborating to compete’ by salvaging others that were hard-hit by Government deposits withdrawal. An example was when UBA rescued BON from serious deficit problem.

**Analysis of Findings**

Naturally, every adjustments have both intended and unintended consequences. The most immediate impact of deposits transfer by Government from the volts of commercial banks to CBN is expected to be a reduction in the amount of currency in circulation.

**Table I:** Data of Inflation, Exchange Rate and Money Supply in Nigeria (1986 – 1992)

<table>
<thead>
<tr>
<th>Year</th>
<th>Inflation</th>
<th>Exchange Rate</th>
<th>Money Supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>5.4</td>
<td>2.0206</td>
<td>13,105.00</td>
</tr>
<tr>
<td>1987</td>
<td>10.2</td>
<td>4.0179</td>
<td>14,905.90</td>
</tr>
<tr>
<td>1988</td>
<td>38.2</td>
<td>4.5367</td>
<td>21,486.02</td>
</tr>
<tr>
<td>1989</td>
<td>40.9</td>
<td>7.3916</td>
<td>23,167.70</td>
</tr>
<tr>
<td>1990</td>
<td>7.5</td>
<td>8.0378</td>
<td>37,233.70</td>
</tr>
<tr>
<td>1991</td>
<td>13.0</td>
<td>9.9095</td>
<td>47,364.50</td>
</tr>
<tr>
<td>1992</td>
<td>44.5</td>
<td>17.2984</td>
<td>65,172.50</td>
</tr>
</tbody>
</table>

[Source: Central Bank of Nigeria Annual Report for Various Years].

As can be observed in Table I, money supply in 1989 was even higher than in 1988 by N1, 680.68 billion representing an increase of 7.8 per cent. Also, the amount of money supply in 1989 was 76.79 per cent higher than the amount in 1986. As Government withdrew N13 out of the N23 billion that was in circulation, banks had to embark on aggressive marketing through door-to-door and increase in branch network in order to mobilise deposits from the public. It made banking services to be more efficient and innovative thereby making depositors to become kings. Earlier, the withdrawal of foreign guarantees for bank loans had sucked an estimated N1.2 billion from circulation.

**Table II:** Percentage Change in Inflation, Exchange Rate and Money Supply for 1989

<table>
<thead>
<tr>
<th>Year</th>
<th>Inflation</th>
<th>Exchange Rate</th>
<th>Money Supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>(657.41%)</td>
<td>(265.81%)</td>
<td>(76.79%)</td>
</tr>
<tr>
<td>1987</td>
<td>(300.98%)</td>
<td>(83.97%)</td>
<td>(55.43%)</td>
</tr>
<tr>
<td>1988</td>
<td>(7.07%)</td>
<td>(62.93%)</td>
<td>(7.83%)</td>
</tr>
<tr>
<td>1989</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>1990</td>
<td>(81.66%)</td>
<td>8.94%</td>
<td>60.71%</td>
</tr>
<tr>
<td>1991</td>
<td>(68.22%)</td>
<td>34.06%</td>
<td>104.44%</td>
</tr>
<tr>
<td>1992</td>
<td>8.80%</td>
<td>134.03%</td>
<td>181.31%</td>
</tr>
</tbody>
</table>

[Source: Computed by the Author from Table I].
There was also a positive impact on the rate of inflation in the country as a result of Government deposits withdrawal. Inflation drastically reduced from 40.9 per cent in 1989 to an average of 7.5 per cent in 1990 despite an increase of N14,066.00 billion in money supply. However, three years after the deposits withdrawal, money supply had not only increased almost three-folds to N65,172.50 billion but inflation was 44.5 per cent in 1992 which was 8.8 per cent more that the rate in 1989. This means that although the economy seemed to have been turned around as a result of Government transfer of deposits from commercial banks to CBN, it shows that there was actually no fiscal discipline on the part of authorities. This is also attested to by the Naira exchange rate to the US Dollar.

Whereas the exchange rate was N7.3916 to a US Dollar in 1989 it kept increasing by the years and in 1992 it increased to N17.2984 per one US Dollar which was more than double the 1989 exchange rate. This monumental depreciation in the value of the Naira may not be unconnected with the amount of money supply during the period. This simply waived the gains made from money mob-up in 1989. It also meant that the sufferings and sacrifice made by MDAs, companies, contractors, families and individuals to accommodate and adjusted to the cash crunch during the chaotic banking process all went away in vain.

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