Inclusive Sectoral Financing for Sustainable Economic Growth

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Abstract

The dominance of the oil sector in government revenue and export has constrained the implementation of fiscal and monetary policies in Nigeria. Declining oil revenue limits the ability of the government to fund its budget, while the dominance of oil as the major foreign exchange earning sector complicates the implementation of monetary policy in Nigeria. The Central Bank of Nigeria (CBN) has implemented several policies to influence the lending pattern of commercial banks to certain sectors in a bid to enhance government revenue and economic growth. However, available statistics suggest that the sectoral lending pattern of commercial banks is not reflected in the sectoral composition of the gross domestic product (GDP) and export. It turns out that the agricultural sector which accounted for the highest share of GDP (21%) received about 4% of banks' loans. While the downstream oil and gas sector which received the largest chunk of bank loans (21%) contributed less than 9% to GDP. The Upstream oil and gas sector which received 9% of banks' loans accounted for over 90% of commercial banks' loans. A continuation of the observed trend in bank lending could limit the growth of the key contributors (sectors) to GDP and thus threaten the sustainability of GDP growth. Three recommendations are proposed in this paper toward ensuring the sustainability of the growth of the key contributors to GDP and export. Firstly, CBN interventions in banks' lending activities should enhance the growth of key contributors (sectors) to GDP, export, and government revenue. Secondly, the federal government should lead in the financing of large-scale manufacturing (textile, steel, and petrochemicals) in partnership with the private sector. Thirdly, the funds in the excess crude oil account should be dedicated to the infrastructural development of the industrial sector.

Introduction

The quest for diversification of the Nigerian economy is one that requires purposeful, coherent, and consistent strategies to achieve. To start with, it is imperative to define economic diversification explicitly to avoid generic usage. In this paper economic diversification is conceived regarding spread in the sectoral composition of gross domestic product (GDP) and export of the Nigerian economy. Thus, economic diversification is defined from an intensive perspective. GDP and export diversification aid sustainable economic growth and development by reducing the impact of negative sectoral shocks on the economy. The COVID-19 pandemic is a recent shock that led to the lockdown of countries and reduced global economic activities. While the impact of the shock is evident across all sectors of the Nigerian economy, its impacts on the oil market have a multiplier effect on the Nigerian economy. The federal government's 2020 revenue projection was revised downward by 40%, due to the decline in projected oil price and oil production by 47% and 22% respectively

(Iroanusi, 2020). The problem of low revenue has persisted for a while. For instance, between the years 2016 and 2019, the federal government realized revenue consistently fell below budgeted revenue. This low revenue resulted in increasing fiscal deficits and rising debt levels. The gravity of the revenue challenge is evident in its emergence at the top priority target in the 2020-2022 medium-term expenditure framework.

The challenge with the declining and volatile oil revenue implies non-oil revenue must grow and replace the declining oil revenue, to sustain the growth of the economy's aggregate demand. The ability of the government to generate non-oil revenue is a function of the production level of the non-oil sectors. The production level of the non-oil sectors is dependent on their accessibility to production inputs. Physical capital (for example plant, machines, and building) is one of the production inputs that firms often require external financing to acquire, given the huge cost requirement. The access to funding is skewed towards the oil sector as it accounted for the highest share of commercial banks' loans in recent years. The high cost of bank loans (16% — 30%) and the short loan tenor (five years or lower) often limits the access of firms in the non-oil sectors to banks loans (Al-Kawaz, 2008). Banks often favour oil firms due to their high rate of return and short investment payback relative to firms in the non-oil sectors.

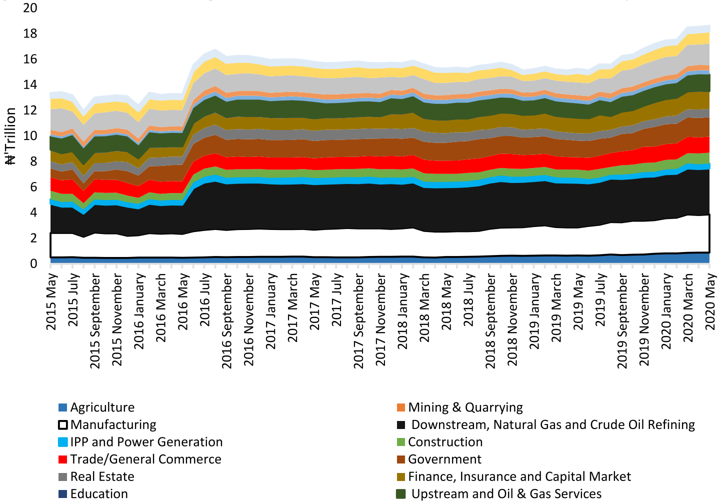
This paper examines the implication of the concentration of commercial banks' loans towards the oil sector for the sustainability of economic growth and development of the Nigerian economy. The remaining sections of this paper focus on stylized facts on economic diversification and sectoral financing, the role of capital accumulation in economic growth, and the policy recommendation in sections two, three, and four respectively.

Stylized Facts: Sectoral Financing and Economic Diversification

This section analyses the structure of bank loans, GDP, and export using available statistics. It is evident from statistics that the main recipients of commercial banks' loans are not the major contributors to gross domestic product and export of the Nigerian economy. According to Figure 1, four sectors accounted for 51 % of commercial bank loans between May 2015 and May 2020. These four subsectors are: the downstream, natural gas and crude refining; manufacturing; government; and general service which accounted for an average of 21%, 14%, 8.3%, and 8.1% of banks loan.

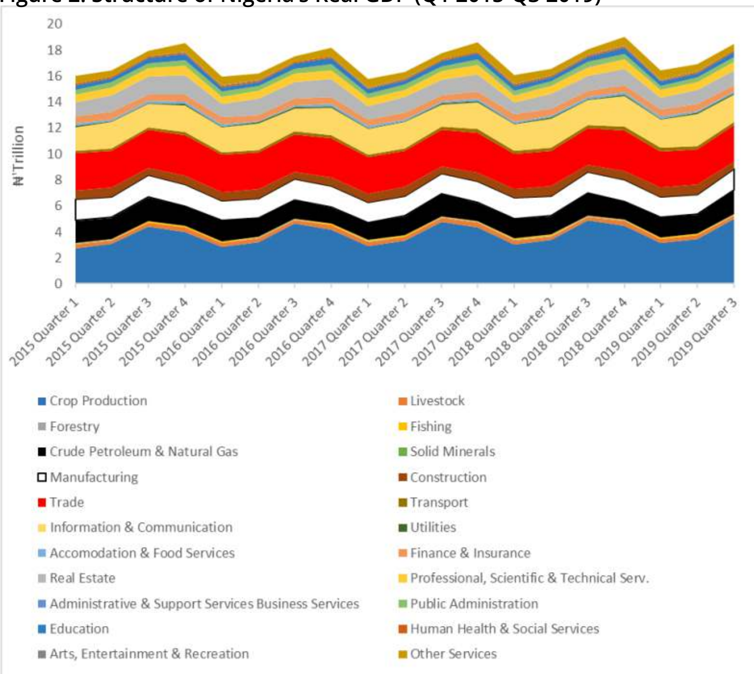
Analysing the composition of GDP using Figure 2 shows that the top four sectors accounted for 60% of GDP between quarter 1 of 2015 and quarter 3 of 2019. The top four sectors are: crop production; trade; information and communication; and crude petroleum and natural gas which accounted for 22%, 17%, 12%, and 9% respectively. It is

Figure 1: Sectoral composition of Commercial Banks' loans (May 2015- May 2020)



Source: CBN Statistical Database

Figure 2: Structure of Nigeria's Real GDP (Q1 2015-Q3 2019)

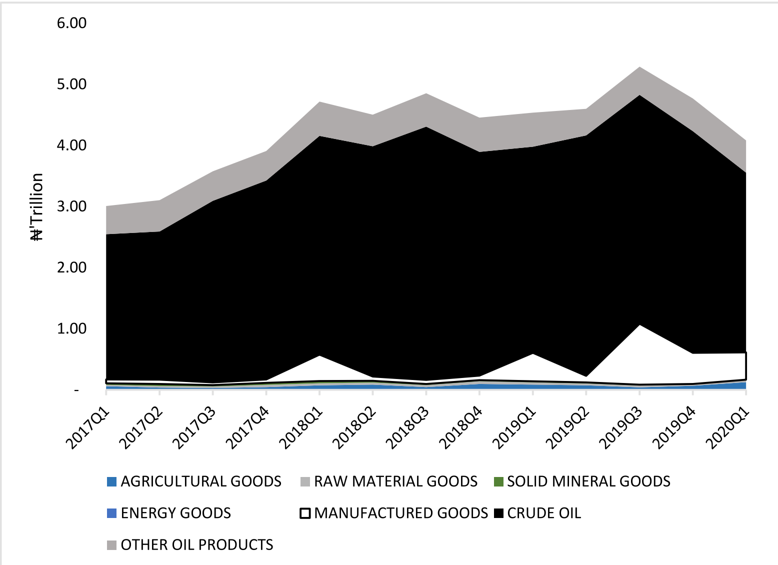


Source: CBN Statistical Database

interesting to note that while crop production (a subsector of agriculture) accounted for 22% of GDP, the agriculture sector received only 4 % of commercial banks' loans. While the leading receiver of bank loans, the oil and gas sector only contributed 9% to GDP.

Regarding export composition; according to Figure 3, crude oil and its by-products accounted for an average of 91% of total export. The export of crude is attributable to firms in the upstream oil and gas sector, and this sector accounted for 8% of commercial banks' loans. Manufacturing and agriculture which received 14% and 4% of total banks' loans, contributed only 6% and 2% to export respectively.

Figure 3: Structure of Nigeria's exports (Q1 2017- Q1 2020)

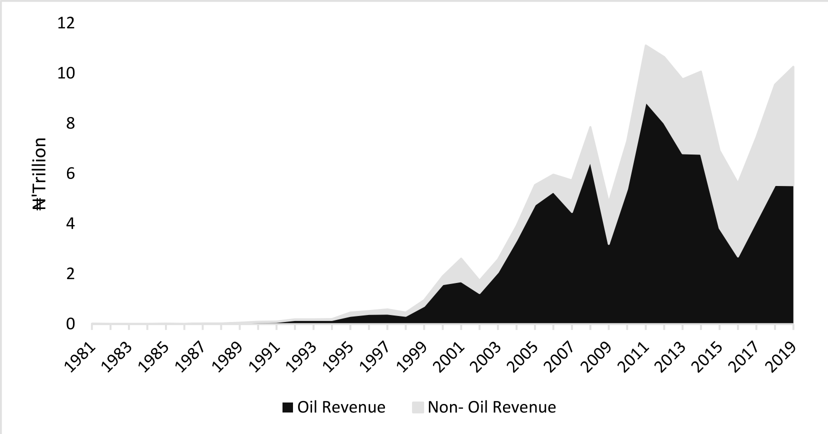


Source: National Bureau of Statistics

In terms of revenue composition, oil revenue has been the leading contributor to government revenue between 1981 and 2019, when it accounted for an average of 73% of total government revenue. However, looking at Figure 4, in recent times, between 2015 and 2019, the contribution of non-oil revenue has increased significantly, when it accounted for an average of 46%.

Having examined the sectoral compositions of banks' loans, GDP, export revenue, and government revenue using the available statistics, it is observed that the pattern of sectoral compositions of commercial banks' loans is not replicated in the sectoral composition of GDP and export. If the statistics presented in this section are anything to go by, they suggest that the loan

Figure 4: Structure of Government Revenue (1981-2019)



Source: CBN Statistical Bulletin (2019)

behaviour of commercial banks in Nigeria does not support sectors that help sustain economic growth in Nigeria.

Investment and Economic Growth in Developing Economies

One critical feature that has been observed for countries that achieved sustainable economic growth and development is capital accumulation; even though Neoclassical growth theories (Solow, 1956; Cass, 1965) suggest that there is a limit to economic growth that can be generated for stimulating capital. However, studies on the emergence of the Asian Tiger have suggested that capital accumulation played a crucial role in their growth and development (OECD, 2013). The question then is what capital accumulation strategies a developing country like Nigeria can utilize to catch-up with the developed economies. Development economics literature provides two alternative approaches to how developing countries can build their capital stock to achieve sustainable economic growth. They are the balanced/big push and unbalanced growth model. The balanced growth model assumes that developing countries are characterized by low-income, and a small demand market (their access to the International market is low). Thus, to develop and sustain growth, they need to invest in multiple sectors simultaneously, which will help create markets for the output of various sectors (Resenstein-Rodan, 1943; Ranger Nurkse, 1952).

Hirschman (1958) however challenged the big push model on the premise that developing countries cannot afford to invest in multiple sectors due to their low-income and investment levels. Thus, to create a sustainable growth path, developing countries should devote investment toward sectors with high forward and backward inter-sectoral linkages.

An example is an investment in vehicle engine production. This will have a backward link to steel producers, which is a crucial input and have a forward link to the car production factories. Thus, direct investment in one production chain helps in building the entire value chain for a product. However, in the case of Nigeria, the population size of the economy and the signed African Continental Free Trade Area (AfCFTA) suggest that a huge market exists for the country to explore. The relevant question is how the country should plan its investment pattern to reduce its dependence on the oil sector and enhance the output of other sectors in the economy. Potential strategies are proposed in the next section.

Policy Recommendation

1. **CBN interventions in banks' lending activities should enhance the growth of key contributors (sectors) to GDP, export, and government revenue.** The CBN in recent times has requested banks to extend loans to certain sectors. For example, deposit money banks are to maintain a minimum of 65% loan to deposit ratio with priority being assigned to SMEs, retail, mortgage, and consumer lending. While the growth of these sectors is crucial for economic growth, the sectors that account for significant shares of GDP, export and government revenue, should also be given priority in commercial bank lending, to avoid the risk of stunted growth in these sectors. For example, crop production which contributed 22% of GDP received less than 4% of banks' loans and the upstream oil sector which accounts for the majority of government revenue and foreign exchange earning received only 8% of bank loans.

2. **Government-led industrialization financing.** Sectors that can generate substantial revenue, employment, and foreign exchange earnings are required to put the Nigerian economy on a sustainable path. The industrial sector is a sector with the potentials to meet these three targets. The growth of industries in China, and the Asian Tiger economies were largely influenced by government intervention in providing adequate financing and a business enabling environment, to ensure rapid industrialization is achieved. Leaving financial markets to determine resource allocation will not achieve any significant industrialization. The high lending rate and the short-term nature of the loans offered by commercial banks restrain the ability of firms within the industrial sector to access funds. The government, therefore, needs to provide financial support and active monitoring for firms to engage in large scale manufacturing with a specific focus on textile, steel, and petrochemical.

The access to raw material and existing steel production facilities puts these manufacturing activities in the forefront. The government has successfully established joint ventures with the private sector in the oil and gas sector, it can equally apply a similar approach in the industrial sector.

3. **Utilize the excess oil fund for Industrialization.** The excess crude oil account is an example. This fund can be used to provide cheap and long-term funding support to firms in the manufacturing sector, rather than utilizing the fund to supplement government revenue shortfalls. With the current African Continental trade agreement, Nigeria has a lot to harness in producing and exporting industrial goods, as most African countries engage in the export of primary goods such as agricultural produce and natural resources.

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