

# INTERNATIONALIZATION OF FINANCE AND ECONOMIC DEVELOPMENT IN NIGERIA: A BENEFIT-COST ANALYSIS

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## Introduction

One of the principal characteristics of the world economy in recent years has been the rapid pace at which financial activity has grown and become international in character. Banks have played a key role in the internationalization of finance both on behalf of their customers and on their own account. Thus, their deposits and loans have become increasingly and for many banks, highly diversified in their country composition, and cross-border fee-earning activities have become increasingly important sources of profit and growth.

The expansion and diversification of international banking has in part been due to the growth of other transnational corporations whose overseas branches, subsidiaries and affiliates have drawn in the banks which served them in their home base, both to provide international banking services and to deal with the residents of the host countries. But at the same time, financial innovation and deregulation have blurred the distinction between banks and non-bank financial institutions most notably in a number of major financial centres: banks have increasingly entered into lines of business from which they were previously barred, while various other types of institutions have taken on banking activities of various kinds. Financial services have as a result become more easily "unbundled" and traded, domestically and globally.

The crucial problem this paper seeks to solve is whether the internationalization of finance has improved economic development in developing countries, particularly Nigeria.

## Internationalization of Finance: Scope and Dynamics

Finance is the core of business in any modern economy. This is true in industrialized countries as well as in developing economies. It is also important to note that the structure of ownership and control of business enterprises is changing fast: financial resources are needed by both the private and public sectors to maintain productive capacity and promote new investment in hitherto unexplored fields. The primary function of a financial system is to transfer funds from savers to investors. Reconciling the desire of the former to remain liquid with the need of the latter to acquire indivisible, illiquid physical assets, financial intermediaries (such as banks) can help achieve the required maturity transformation by holding assets that are more liquid than their liabilities. Thus, they carry a liquidity risk for which they expect to earn profits. Strictly speaking, the term "domestic finance" covers only financial transactions among residents denominated in the country's own currency (the home currency).

In the Trade and Development Report 1990 (UNCTAD 1990), it was pointed out that international finance involves either a non-resident or assets denominated in a foreign currency, or both, i.e. financial transactions across borders or across currencies. International banking thus involves claims and liabilities vis-a-vis non-residents denominated in either home or foreign currencies. The definition of international finance is wider than euro currency or offshore banking, which excludes international bank loans to and deposits of non-residents de-

nominated in the home currency. It also includes bond and equity issues in Eurobond and Euroequity markets. However, domestic and international transactions are not segmented into separate markets. According to UNCTAD 1990, when the financial market of a country is opened to non-resident investors and/or borrowers, or when residents are allowed to deal in foreign currency assets and liabilities, these markets become internationalized. As national and international financial transactions develop, relations of substitutability and complementarity with purely domestic characteristics become subject to strong external influences. The combined size of world financial markets can be estimated at over \$36,000 billion, half of which is accounted for by commercial banks. Table 1 shows the size and structure of world financial markets in 1982 and 1988.

The figures in Table 1 include total gross assets of commercial banks and stock and bond markets in major financial centres, and eurosecurity issues. The 1980s witnessed a major shift in international financial intermediation from banking to security markets (securitisation). UNCTAD, 1990 in its report says international bank lending slowed down, reflecting the cutback of lending to developing national borrowers and direct security issues were on the increase. While eurobond markets became important, euroequity markets emerged. Also, while securitisation reduced the share of international lending in world markets, it increased the involvement of banks in security transactions, greatly widening the grey area between banking and security market transactions, often in the form of off-balance sheet business. Securitisation has gone hand-in-hand with the introduction of a variety of new financial instruments (e.g. rate-issuance facilities, swaps, options, and forward rate agreements) designed to reduce investors' exposure to credit, liquidity and exchange rate risks.

In the 1980s, the internationalization of finance also meant financial deepening at a global level. Growth in world output, trade and investment naturally tends to cause the volume of financial transactions to grow. However, over the last two or three decades, the pace of growth of international financial transactions has been far in excess of that of real variable. This is clearly shown in Table 2 which compares two measures of international banking with indicators of 'real' world economic activity—production, trade and investment. The figures tend to underestimate the deepening since, as noted above, securities transactions have grown even faster than international banking.

Since the early 1970s, international banking has grown at more than 20 per cent per annum, i.e. about twice as fast as international trade (12 per cent) and world output (10 per cent). Between 1972 and 1987 world trade increased by about \$ 2,500 billion whereas international banking expanded by \$ 4,000 billion. In 1987, the stock of international bank assets exceeded world trade by about 40 per cent. A comparison of finance with capital accumulation would provide an even better measure of financial deepening in view of the role of finance in converting savings into investment. Between 1982 and 1988, the annual increment in the stock of world financial assets was, on average, about \$ 3,800 billion, whereas the annual average level of world fixed capital formation was around \$ 2,300 billion. The ratio of the size of the international banking market to global fixed investment doubled in less than a decade as shown in Table 2.

The strong tendency for the pace of the internationalization of finance to outstrip the growth of real activity has been facilitated (and itself accelerated) by developments in communication and transportation technology, particularly in electronics. These have allowed information to be acquired, processed and disseminated much more rapidly and at very low costs, and to greatly improve the payments transmission mechanisms across countries. As a result opportunities for cross border arbitrage have increased, the costs of international financial transactions have been reduced and national markets have been brought closer together. Rizzi (1989) stated that the progressive dismantling of policy barriers to capital movements has also played a cardinal role. Financial deregulation and liberalization quickened after the collapse of the Bretton Woods System and has further accelerated in the 1980s. As a result the financial system prevailing in the major

countries now has the following broad characteristics:

- \* cross-border and foreign exchange credits are virtually unrestricted in all the countries concerned;
- \* cross-border and foreign exchange deposits are allowed in major financial centres, and are being liberalized in others (e.g. some member countries of EEC);
- \* security transactions now enjoy a high degree of freedom.

Since the early 1970s, freedom of capital movements has been increasingly viewed as an important policy objective. This trend is in stark contrast to government attitudes in the post-war years: the Bretton Woods era was based on a consensus that capital flows unrelated to foreign direct investment should be discouraged (or even prevented).

The failure of controls imposed under the Bretton Woods System to check capital movements also played an important role in changing official attitudes towards financial deregulation. Most controls and regulations were adopted ad hoc for macroeconomic reasons, and did not slow down the growth of unregulated offshore markets and relocation of financial activities. This in turn entailed a more liberal treatment of financial operations in order to avoid a loss of competitiveness for domestic financial institutions. Similarly, Begg, et al had observed that competition among national financial markets has been an important factor in the proliferation of deregulation and the reduction or abolition of taxes. When many major financial centres deregulate, the rest has little choice but to follow suit. The process tends to be circular and cumulative also because markets themselves generate pressures for further freedom; for deregulation generates fluctuation and turnover for many financial operations on which their profits depend.

Now, let us consider the question of financial openness in developing countries. Financial openness is the ease with which residents can acquire assets or liabilities in foreign exchange, and non-residents operate in national financial markets. In developing countries, the degree of financial openness is not accurately reflected by the restrictiveness of regulations ostensibly in force. The administrative capacity to implement rules effectively is often lacking, and the underdevelopment of financial intermediaries and the importance of informal financial markets

make it relatively easy to circumvent regulations.

The first wave of liberalization in developing countries generally took the form of allowing the private sector to borrow abroad. This happened not only in the southern core countries in Latin America after the mid 1970 in the context of broader programmes of financial deregulation, but also in a number of countries where domestic financial markets continued to be highly regulated e.g. in countries like Turkey, Yugoslavia and Philippines. The freedom to borrow triggered a massive build-up of foreign exchange liabilities in the private financial and non-financial sectors particularly in countries where borrowers continued to enjoy exchange rate guarantees or where domestic rates rose sharply. The consequent over-borrowing by the private sector contributed significantly to the subsequent debt servicing difficulties and the debt crises. In many such countries governments found it necessary to subsidize private debt servicing through special exchange rates, or assume the liabilities of insolvent financial institutions. Controls over foreign borrowing by the private sector were subsequently reinstated in many such countries.

Resident banks are now generally allowed to hold a short-term foreign exchange liabilities vis-a-vis international capital markets provided they are for financing trade, and covered by short-term foreign exchange claims on exporters. Increased financial openness and dismantling of barriers to capital flows have considerably strengthened the links among the financial markets of national economies. This has had significant implications for national policy autonomy and domestic/global effects on national economic policy. The degree of policy autonomy has declined everywhere, but most of all in smaller and/or less developed countries having a high degree of financial openness. On the other hand, the global effects of the policies pursued by the major countries have increased considerably, even though their policy autonomy too have diminished. Policy autonomy refers to the ability of national policy makers to control national policy goals by using the policy instruments at their disposal.

The main argument put forward in favour of financial openness and internationalization of finance is the same as that for trade liberalization, namely that it would improve

TABLE 1  
SIZE AND STRUCTURE OF WORLD FINANCIAL MARKETS IN 1982 AND 1988

	1982		1988	
	Value of Assets (\$ billion)	Percent of Total Assets	Value of Assets (\$ billion)	Percent of Total Assets
Bank Assets <sup>(a)</sup>	8,897	64.1	17,005	46.6
Domestic	6,218	44.8	11,500	31.5
International	2,669	19.3	5,505	15.1
Capital Markets	4,977	35.9	19,507	53.4
Euroequity	-	-	40	0.1
International Bank Markets <sup>(b)</sup>	259	1.9	1,085	3.0
Stock Markets	1,591	11.5	9,563	36.2
Bond Markets	3,129	22.0	6,819	24.1
Total	13,864	100.0	36,512	100.0

Source: International Banking and Financial Market Developments, Capital market information was supplied by Salmon Brothers International. All data are end fear data.

(a) Gross size of banks' balance sheets.

(b) Eurobonds and foreign banks.

the allocation of resources internationally. The reasoning is that, if allowed to move freely, capital would flow to countries in response to opportunities for real investment, thereby equalizing rates of return on investment everywhere, and allow individual countries either to save more than they invest, or to invest more than they save according to market disciplines. This can be seen as capital mobility, speculation and rates of return. Table 3 shows that annual increases in cross-border banking transactions are several times greater than the annual net capital flows across countries. Table 4 puts together some data on international banking and also covers major financial markets and offshore centres. Almost one-third of total bank assets in this group of countries taken together

qualifies as international. About two thirds of international assets are inter-bank transactions. Data for 1982 and 1988 are not directly comparable particularly in the Federal Republic of Germany and Japan; between these dates the deutsche mark appreciate against the dollar by nearly 40% and the Yen by more than 90% raising considerably the dollar value of total bank assets in these countries. Nevertheless they reveal a number of tendencies regarding changes in the importance of international banking. First, there has been a significant increase in the share of international banking in Japan despite the Yen appreciation. Second, there has been a decline in the share of offshore centres in international banking (from about 25 per cent in 1982 to 20 per cent in 1988), and in

the share of international banking in some traditional financial centres such as London. This probably reflects competition, financial deregulation and liberalization by other centres.

Let us also note that the internationalization of finance and integration of financial markets have considerably increased the importance of securing an exchange rate system conducive to financial stability. For one thing, they increased denomination of assets and liabilities of financial intermediaries, debtors and investors in foreign currencies mean that the value of assets and liabilities is directly influenced by exchange rate changes. For another, events in exchange markets can exert a strong influence on asset (e.g. bond and equity) prices because exchange rate expectations can induce funds to be shifted among securities denominated in different currencies and/or because policy measures taken to manage exchange rates or to deal with inflationary or deflationary influences of exchange rate changes alter interest rates and security prices. Exchange rate instability can therefore increase the level of risk in the financial system. For instance, banks can incur substantial losses when there is a serious mismatch between currency denomination of their assets and liabilities. Many governments in major countries have introduced regulations restricting open position. However, perfect matching (e.g. by taking forward cover) is very difficult and costly particularly since bank liabilities are much shorter in maturity, and their currency composition can undergo sharp changes.

TABLE 2  
INTERNATIONAL FINANCIAL DEEPENING:  
INTERNATIONAL BANKING IN RELATION TO WORLD OUTPUT, TRADE AND INVESTMENT, SELECTED YEARS

	1964	1972	1980	1983	1985	1987
	As a percentage of world output					
Net International Bank Loans	0.7	3.7	8.0	12.0	13.2	14.8
Gross Size of International Banking Market	1.2	6.3	15.5	21.8	25.3	27.9
	As a percentage of world trade					
Net International Bank Loans	6.4	25.7	35.2	57.3	63.9	72.9
Gross Size of International Banking Market	10.6	43.8	67.8	104.0	122.2	137.2
	As a percentage of world fixed investment.					
Net International Bank Loans	4.0	18.0	39.2	66.3	72.4	78.2
Gross Size of International Banking Market	6.7	30.6	75.4	120.5	138.7	147.3

Source: UNCTAD Secretariat estimates; BIS, Annual Report (various issues) and Morgan Guaranty, World Financial Markets (Various Issues).

Note: The Table relates the stock of bank loans outstanding at the end of the year to world output, trade and gross investment in current dollars during the year.

TABLE 3  
THE GROWTH OF INTERNATIONAL BANKING RELATIVE TO FOREIGN DIRECT INVESTMENT  
AND  
NET CAPITAL FLOWS ACROSS COUNTRIES

	1972-1979	1980-1984	1985-1987
	As a percentage of foreign direct investment		
Net International Bank Loans	331	217	487
Gross size of International Banking Market	650	391	889
	As a percentage of net capital flows across countries <sup>(a)</sup>		
Net International Bank Loans	161	115	224
Gross size of International Banking Market	316	219	

Source: UNCTAD Secretariat estimates based on Bryant, op. cit: BIS Annual Report (various issues) and Morgan Guaranty World Financial Markets (various issues).

(a) Net Capital flows are measured as the absolute sum of current account balances divided by 2.



TABLE 4  
TOTAL AND INTERNATIONAL ASSETS OF BANKING OFFICES IN SELECTED INDUSTRIAL COUNTRIES  
AND  
OFFSHORE BANKING CENTRES 1982 AND 1988

Country/Centre	Assets with International Characteristic (as a percentage of total assets)									
	Total Assets <sup>(a)</sup> (\$ billion)		International assets as a percentage of total assets		Claims on non- residents in foreign currencies		Claims on non- residents in home currencies		Claims on residents in foreign currencies	
	1982	1988	1982	1988	1982	1988	1982	1988	1982	1988
8 European countries <sup>(b)</sup>	3811	7427	31.9	30.7	19.9	19.7	4.5	4.8	7.4	6.3
Of which:										
United Kingdom	893	1841	72.3	62.4	48.9	43.8	2.9	4.2	20.5	14.4
Federal Republic of Germany	1140	2529	7.5	8.3	1.7	2.4	5.6	5.7	0.2	0.2
France	654	1271	28.8	27.3	19.0	18.4	3.7	3.3	6.1	5.6
United States	2109	3048	17.2	18.4	0.4	2.3	16.8	16.1		
Japan	1157	4625	15.4	25.0	5.7	8.4	2.2	7.4	7.5	9.1
11 Industrial Reporting Countries <sup>(c)</sup>	7313	15504	24.9	26.2	12.4	12.7	7.6	7.7	5.4	5.9
8 Offshore centres <sup>(d)</sup>	660	-	87.4	-	75.6	-	1.3	-	10.5	-

Source: 1982 data (except for Japan) from Ralph C. Bryant, International Financial Intermediation, Washington D.C., 1987. All data are end year.

(a) Gross size of banks' balance sheets.

(b) Belgium, Federal Republic of Germany, France, Ireland, Italy, Netherlands, Switzerland and the United Kingdom.

(c) The eight European countries, plus Canada, Japan and the United States.

(d) Bahamas, Bahrain, Cayman Islands, Hong Kong, Lebanon, Netherland Antilles, Panama, Singapore.

TABLE 5  
TRANSNATIONAL BANKS AND ECONOMIC DEVELOPMENT IN NIGERIA

	1980	1981	1982	1983	1984	1985	1986	1987	1988
External Debt (\$ million) (\$ million)	1,866.8+	2,331.2	2,594.7	18,500.0	20,982.7	29,337.8	41,451.9	100,789.1	133,956.5
GDP (\$ million)	31,540.8	95,363.0	95,468.9	78,884.3	68,662.1	74,468.2	77,900.0	79,280.0	82,580.0
Per Capita Income (\$)	374+	1,102	074	867	763	778	809	787	-
Balance of payment (\$ million)	+2,402.2	-3,020.8	-1,398.3	-301.3	+354.9	+349.1	-796.4	+159	-2,294.1

+1977/78 prices others 1984 prices.

+Surplus - Deficit

Source: Central Bank of Nigeria Annual Reports (1980-1988).