European Journal of Social Sciences
ISSN 1450-2267 Vol. 44 No 2 September, 2014, pp.221-229
http://www.europeanjournalofsocialsciences.com/

Monetary Policy and the Informal Sector in Nigeria, 1970 - 2011

Jonathan Emenike Ogbuabor
Corresponding Author, Department of Economics
University of Nigeria, Nsukka, Enugu State, Nigeria
E-mail: jonathan.ogbuabor@unn.edu.ng
Tel: +2348035077722

Ifeoma C
Department of Economics, University of Nigeria
Nsukka, Enugu State, Nigeria

Anthony Orji
Department of Economics, University of Nigeria
Nsukka, Enugu State, Nigeria

Abstract

This study examined the impact of CBN monetary policy on informality in Nigeria over the period 1970-2011 using an ordinary least squares methodology. The results indicate that money supply impacts positively and significantly on informality; while other monetary variables such as minimum rediscount rate, exchange rate, inflation rate, and liquidity ratio do not impact significantly on informality in Nigeria. This finding implies that expansionary monetary policy that favours increased money supply in Nigeria encourages informality. The results further indicate that the burden of taxation and government regulatory activities in the economy are significant drivers of informality in Nigeria.

Keywords: Monetary Policy; Money Supply; Informality; OLS; CBN; Nigeria

1. Introduction

If left to allocate themselves freely in an economy, money and credit flows are very unlikely to achieve some specific macro-economic policy objectives. To achieve balanced and steady economic growth and development, and to instill some sanity into a country's financial system, the need for monetary policy becomes inevitable. Monetary policy may be defined as a combination of measures undertaken by the monetary authorities (generally the central bank) to regulate and control the volume, cost and direction of money and credit in an economy with a view to achieving predetermined macroeconomic goals (Folawewo and Osinubi, 2006; Dwivedi, 2005; Abata, Kehinde and Bolarinwa, 2012). It is an aspect of macroeconomics which deals the use of monetary instruments designed to regulate the value, supply and cost of money and credit in an economy, in line with the expected level of economic activity. Such monetary instruments include money supply, inflation rate, interest rate, balance of payments, external reserves and exchange rate policies. In other words, monetary policy is a major economic stabilization weapon used to achieve some specified macroeconomic policy objectives and to counter undesirable trends in the economy such as unemployment, inflationary pressures, sluggish

economic growth and external sector instability (Ubi, Effiom and Eyo, 2012; Anyanwu, 1996; Gbosi, 1998; Okowa, 1995).

Clearly, monetary policy influences the volume and direction of purchasing power in an economy and is an instrument of market intervention to achieve rationally stipulated objectives which otherwise would have been impossible of attainment at least in terms of volume, speed and direction (Anyanwu, 1996). The main objectives of monetary policy are the attainment of internal and external balance by ensuring price stability, maintenance of balance of payments equilibrium, promotion of employment and output growth, and sustainable development (Fasanya, Onakoya and Agboluaje, 2013). In Nigeria, the Central Bank of Nigeria (CBN) statutorily regulates the stock of money in the economy through the use of monetary policy that is usually targeted towards the achievement of full-employment equilibrium, rapid economic growth, price stability, and external balance. Over the years, the major goals of monetary policy in Nigeria have often been the two later objectives. Thus, inflation targeting and exchange rate policy have dominated CBN's monetary policy focus based on assumption that these are essential tools of achieving macroeconomic stability (Ajayi, 1999).

The informal sector can be defined as market-based production of goods and services, whether legal or illegal, that escape detection in the official estimates of gross domestic product (GDP). The activities in this sector cover almost every field of economic activity, ranging from petty trading and personal services to informal construction, manufacturing and repairs (Smith, 1994; Ajakaiye & Akerele, 1996; CBN/FOS/NISER, 2001; Oduh et al, 2008). In Nigeria, the activities in this sector include several small and unregistered sole proprietor businesses, and in some instances, joint-partnership businesses which can be found both in rural and urban settlements across the country. However, the nature of the economic activities engaged in varies considerably from one locality to another. For example, in the rural areas, farming activities and allied occupations such as hunting, fishing, weaving, blacksmithing, basket and pot making as well as leather works are more prevalent. However, in urban centres like Lagos, Enugu, Abuja, Port Harcourt, and Kano, informal economic activities include trading, small scale manufacturing and repairing industries, such as carpentry, upholstery, furniture making, woodworks, metalworks, bakery, goldsmithing, tailoring, bricklaying, and printing. Those in the repairing occupations include, among others, the automobile mechanics, electricians, clock and watch repairers, and cobblers, (Olowu & Okotoni, 1996).

Apart from the economic activities enumerated above, numerous informal sector activities in contemporary Nigeria are illicit, especially those conducted on the external scene. These activities include drug peddling/trafficking, currency trafficking, money laundering, smuggling, advance fee fraud (419), over invoicing / under invoicing, 'crude oil bunkering' or theft, kidnapping for ransom, illegal arms trade, human trafficking, among others. Recent empirical evidences in Nigeria point to a growing informal sector (Ogbuabor & Malaolu, 2013; Ariyo & Bekoe, 2012; Oduh et al, 2008). Again, one main feature of informal transactions in Nigeria is that they are mainly conducted in cash to avoid official detection. Over the years, Nigeria has controlled her economy by varying her stock of money, which includes currency (or cash) in circulation (Ojo, 1989). This implies that the conduct of monetary policy by the CBN could have far reaching implications for the informal sector, which thrives mainly in a cash economy. In other words, the monetary policy decisions of the CBN can encourage or deter the emergence and growth of an active informal sector in Nigeria. Unfortunately, none of the existing studies on monetary policy in Nigeria has empirically examined the dynamic response of the informal sector to the conduct of monetary policy in Nigeria. This study seeks to address this research gap. Specifically, the objective of this study is to determine the impact of CBN monetary policy on informality in Nigeria in order to provide evidence based policies that will enhance the growth and development of the Nigerian economy. This study is therefore a major step towards eliminating dualistic markets and promoting a well functioning national economy in Nigeria.