THISDAY LIVE

The Unholy Trinity and Nigeria's Misery Index

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The new Governor of the Central Bank of Nigeria (CBN), Godwin Emefiele, outlined his agenda for the CBN on 5th June, 2014. The two key themes of his speech are essentially, first, managing the unholy or impossible trinity or trilemma in the short term and while, second, tackling the very high misery index of Nigeria over the longer term. In the near term, most financial analysts are likely to focus more on the first theme, especially in the light of the achievements of the immediate past Governor Lamido Sanusi on price and exchange rate stability, and the remarkable dexterity with which the acting Governor Alade had restored calm to the financial markets in the past few months.

Robert Mundell, an Economics Nobel Prize Winner, and Marcus Fleming, a former IMF economist, using simplified assumptions, provided powerful analytical insights on the interactions of policy instruments using the impossible trinity concept. The key simple message of the unholy trinity is that a central bank cannot have it all; at best, it will be able to simultaneously achieve only two of the three objectives of lowering interest rates, ensuring relatively stable exchange rates, and preserving foreign reserves. In the real world, China and the East Asian countries, especially Malaysia, have demonstrated that the trilemma can be managed, if not completely eliminated. They have accumulated huge foreign reserves ($3.7 trillion for China and $130 billion for Malaysia), recorded relatively lower interest rates (China at 6% and Malaysia at 3%), and prevented momentum-driven overshooting of their exchange rates, while focusing on the key determinant of sustainable long-term exchange rate—an expanding economy driven by both factors accumulation and productivity.

A highly productive and growing real economy will over the long-term reflect in an appreciating, or at least stable, currency. Over a period of thirty years, the nominal exchange rate of the Nigerian currency declined in nominal terms from 1 Naira to US$1 in 1983 to 160 Naira to US$1 in 2013. Thus, the issue of liquidity management framework in Nigeria and its implications for exchange rate stability are areas worth looking into constructively to address the perennial rising liquidity in the economy, without corresponding increase in credit to real and productive sectors, and the high cost of mopping excess liquidity.

The most important theme of Emefiele's speech is, arguably, the need for the CBN to transition from focusing primarily on short term stability issues to long-term structural issues. This is significant to addressing and tackling the very high Nigeria's misery index. What is the misery index? The misery index was first developed as the sum of the inflation and unemployment rates by a distinguished economist and a former chairman of the United States President Lyndon Johnson's Council of Economic Advisers, the late Arthur Okun. The misery index was refined by Robert Barro, a Harvard economist; and later modified by Steve Hanke, an economist at Johns Hopkins University. The modified misery index — a simple sum of inflation, lending rates, and unemployment rates, minus year-on-year per capita GDP growth — has been used to construct a ranking for 89 countries in April 2014 (http://www.cato.org/publications/commentary/measuring-misery-around-world).

Although Nigeria was not included in the earlier ranking of 89 countries, the current modified misery index has been retained and calculated for Nigeria for comparative analysis. The ranking goes from the highest misery index as number one to the lowest misery index as number 89 or 90 when Nigeria is included in the list. Nigeria's misery index is approximately 48--- calculated as the sum of inflation rates (8%), unemployment rate (24%), prime lending rates (20%), and minus real per capita GDP growth (4%). If the higher maximum lending rate of about 30% to SMEs is used, the country's misery index will be at 58; and close to 80, when the youth unemployment rate is applied.

Thus, for comparative analysis, we will use the lowest misery index of 48, which will put Nigeria as the country with the third highest misery index--- below Venezuela (79.4) and Iran (61.6), first and second on the list respectively. Among the other SANE countries---South Africa (37.4) is ranked 8, Egypt (38.1) is ranked 6, and Algeria (16.8) is ranked 46, the lowest ranked country in Africa, along with Mauritius (18.2) ranked at 42. Among the BRIC countries, Brazil (37.3) is ranked 10 (9 in the original ranking), while Russia (19.9), India (25.6), and China (7.9) are ranked 37, 23, and 82 respectively. Malaysia (7.88) is at 83. Among the G5 developed countries G5, Japan (5.4), Germany (9.08), USA (11), UK (12.9), and France (13.9) are ranked 89, 78, 71, 62 and 56 respectively.

The quality of life of people is important to them individually, and should be collectively to society. Most people will prefer lower and stable inflation rates, lower unemployment rates, single digits lending rates, and higher GDP per capita---the combination of these measurable economic indicators is what the misery index has tried to capture. Although, it excludes the poverty rate and inequality measures, yet, with its simplicity, it combines the traditional focus on inflation rate with unemployment rate, high lending rates, and low per capita income.

Governor Emefiele has essentially started the journey towards appropriately redefining the economic welfare function of Nigeria and Nigerians for the CBN. His tenure, in addition to safeguarding the independence of the CBN, should be measured by the progress and success in reducing Nigeria's misery index from 48 by half to 24 in 2016, by another half to 12 by 2018, and by another half to 6 by 2020. To his credit, nearly half of his maiden speech has been devoted to issues of economic development and development finance. He has taken a positive decision to include unemployment rate in the discourse of the Monetary Policy Committee, which is welcome. Governor Emefiele has also alluded to the issue of credit rationing and high lending rates, especially to Small and Medium Enterprises (SMEs), engendered by information asymmetry, adverse selection, and moral hazard, and banks' preference for treasury bills as I have articulated in an Op-ed in February 2014 on "Microeconomics of Banking, High Lending Rates."

The details of Governor Emefiele's proposals on SMEs, agriculture, health, and other sectors remain to be completely fleshed out. To ensure effective and efficient execution of some of these economic development and financial inclusion issues, it may be desirable to upgrade the current Development Finance Department of CBN to a full-fledged Development Finance Directorate under the supervision of another Deputy Governor. This new Directorate will focus better on people-oriented institutions including micro-finance banks (more than 800 of them); and work more effectively with the Ministry of Finance and other Sector Ministries as well as with the long-term and development--oriented institutions such as the proposed Nigeria Development Bank, the current Bank of Industry, Infrastructure Bank, and the newly established National Mortgage Refinancing Company.

High unemployment and high lending rates are the major contributors to Nigeria's misery index. Emefiele has used his high profile office to focus attention rightly on these tragedies of the common. We wish him success in managing the unholy trinity and in progressively reducing Nigeria's misery Index.