CENTRAL BANK OF NIGERIA

UNDERSTANDING MONETARY POLICY SERIES NO 23

ECONOMIC DUALISM

Udoma J. Afangideh

MONETARY POLICY DEPARTMENT
10TH
Anniversary Commemorative Edition

Central Bank of Nigeria
33 Tafawa Balewa Way
Central Business Districts
P.M.B. 0187
Garki, Abuja
Phone: +234(0)946236011
Fax: +234(0)946236012
Website: www.cbn.gov.ng
E-mail: info.dmp@cbn.gov.ng

ISBN: 978-978-53862-5-7

Central Bank of Nigeria
Understanding Monetary Policy
Series 23, November 2012

Aims and Scope

Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

Subscription and Copyright

Correspondence

Enquiries concerning this publication should be forwarded to: Director, Monetary Policy Department, Central Bank of Nigeria, P.M.B. 0187, Garki, Abuja, Nigeria, Email:info.dmp@cbn.gov.ng

Central Bank of Nigeria

Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

Vision

"By 2015, be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

Core Values

- Meritocracy
- Leadership
- Learning
- Customer-Focus

MONETARY POLICY DEPARTMENT

Mandate

To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

Vision

To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

Mission

To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth

FOREWORD

The understanding monetary policy series is designed to support the communication of monetary policy by the Central Bank of Nigeria (CBN). The series therefore, provides a platform for explaining the basic concepts/operations, required to effectively understand the monetary policy of the Bank.

Monetary policy remains a very vague subject area to the vast majority of people; in spite of the abundance of literature available on the subject matter, most of which tend to adopt a formal and rigorous professional approach, typical of macroeconomic analysis. However, most public analysts tend to pontificate on what direction monetary policy should be, and are quick to identify when in their opinion, the Central Bank has taken a wrong turn in its monetary policy, often however, wrongly because they do not have the data for such back of the envelope analysis.

In this series, public policy makers, policy analysts, businessmen, politicians, public sector administrators and other professionals, who are keen to learn the basic concepts of monetary policy and some technical aspects of central banking and their applications, would be treated to a menu of key monetary policy subject areas and may also have an opportunity to enrich their knowledge base of the key issues.
In order to achieve the primary objective of the series therefore, our target audience include people with little or no knowledge of macroeconomics and the science of central banking and yet are keen to follow the debate on monetary policy issues, and have a vision to extract beneficial information from the process, and the audience for whom decisions of the central bank makes them crucial stakeholders. The series will therefore, be useful not only to policy makers, businessmen, academicians and investors, but to a wide range of people from all walks of life.

As a central bank, we hope that this series will help improve the level of literacy in monetary policy as well as demystify the general idea surrounding monetary policy formulation. We welcome insights from the public as we look forward to delivering content that directly address the requirements of our readers and to ensure that the series are constantly updated as well as being widely and readily available to the stakeholders.

Moses K. Tule
Director, Monetary Policy Department
Central Bank of Nigeria

CONTENTS

Section One: Introduction 1

Section Two: Concept of Economic Dualism 3

Section Three: Dualism in Economic Development 7

Section Four: Dualism and Financial Sector Development 9
4.1 Response to Deficiencies of the Formal Financial Sectors and Excessive Regulation 10
4.1.1 Interest Rate Controls 10
4.1.2 Selective credit Allocation 11
4.1.3 Minimum Reserve Requirements 12
4.1.4 Minimum Account Balances 13
4.2 Response to Dualism of Economies of Developing Countries .. 13
4.2.1 Illiteracy 13
4.2.2 Transportation and Communications Network .. 14
4.2.3 Concentration Centres of Economic Activities .. 14
4.2.4 Inadequate Distribution of Social Services 14

Section Five: Nigeria's Dualistic Financial System 17

Section Six: Conclusion.. 19

Bibliography 21

ECONOMIC DUALISM[1]

Udoma J. Afangideh[2]

SECTION ONE

Introduction

Economic dualism describes the existence of two separate economic sectors based on different levels of development, technology and pattern of demand within one country. The original idea of economic dualism is credited to Julius Herman Boeke who in 1954 described the co-existence, in the colonial Indonesian economy and society, the traditional and modern economic sectors. The bulk of dual economies are found in developing and less developed countries. In these economies, a sector focuses on domestic needs and the other on the world export market. It is not out of place for dual economies to also exist within the same sector. For instance, a commercial agricultural entity or modern plantation agriculture could be operating alongside traditional cropping systems.

Most developing economies are often characterized by dual economy and some of the problems they face include a high-wage and capital-intensive industrial sector, existing side-by-side with a traditional sector that is characterized by low-wage. As a result of dualism, developments often proceed unevenly in both sectors. Quite often, the modern sector is synonymous with higher productivity, higher wages, higher capital intensity and persistent unemployment, particularly in the urban areas.

A typical dual economy consists of two sectors: a small urban-industrial and a big rural-agricultural sector. For instance, the manufacturing sector normally displays features of any modern industrial economy, while a much bigger agricultural sector surrounding the advanced one is characterized by a primitive mode of

[1]This publication is not a product of vigorous empirical research. It is designed specifically as an educational material for enlightenment on the monetary policy of the Bank. Consequently, the Central Bank of Nigeria (CBN) does not take responsibility for the accuracy of the contents of this publication as it does not represent the official views or position of the Bank on the subject matter.

[2]**Udoma J. Afangideh** is a Principal Economist in the Monetary Policy Department, Central Bank of Nigeria.

production. As a result, labour market is split into two, with one comprised of relatively well-paid and skilled urban workers, and the other, poorly paid and low-productive rural workers.

This paper discussed role of economic dualism in the Nigerian economy in terms of influencing economic development, financial sector development and financial market segmentation. The rest of the paper is structured as follows: section 2 discusses the concept of economic dualism while dualism in economic development is handled in section 3. Section 4 focuses on dualism and financial sector development and section 5 dwells on Nigeria's dualistic financial system. The paper is concluded in section 6.

SECTION TWO

Concepts of Economic Dualism

The assumption of economic dualism is the split of the sectors of the economy into different organizations, levels of development, and goal structures. Typically, the notion of economic dualism distinguishes between two sectors of the economy in the following form:

- a traditional subsistence sector made up of agriculture in a small-scale, petty trade and handicraft, as well as high labour/low capital intensity and low level of division of labour; and
- a modern sector featuring capital-intensive method of production in the industry and plantation agriculture meant for the global market. The mode of production is capital intensive with high level of division of labour.

The outstanding feature is that the two sectors have little relationships and interdependence with each other, but grows each on its own strength. Generally, the modern sector is seen as an economic territory of the developed economies with its growth and multiplier effects benefiting the developed economies, with slight impact on the domestic economy.

The focus of early literature on economic dualism was on agriculture-industry relationship in a two-sector formalization of the economy. In his seminal paper of 1954, Arthur Lewis presented a classical theoretical model of economic development, which was grounded on the twin assumptions that an unlimited supply of labour exist in the traditional agricultural sector of the less developed countries. The model postulated that as the modern industrial urban sector in these countries began to grow, the large pool of surplus labour would be absorbed. Further refinement of the model by other writers such as Fei and Ranis (1964), Harris and Todaro (1970), Fields (1975), and others dominated development economics literature in the 1950s and 1960s. In their 2004 essay, Kirkpatrick and Barrientos asserted that the seminal paper by Lewis "is widely regarded as the single most influential contribution to the establishment of development economics as an academic discipline". The assumption amongst the proponents of the model is that "with the right mix of economic policies and resources, poor traditional economies could be transformed into dynamic modern economies". Ultimately the subsistence sector's pool of surplus labour is depleted with a rise in wages within the sector. According to Hosseini (2012), it is "needless to say that in Africa and most countries of Asia and Latin America, this transformation did not take place (and the optimism about economic growth prospects in those countries began to give way to concerns about persistent widespread unemployment in the urban sector). It seems that while people left the traditional agricultural sector for the modern capitalist centres, the modern-formal capitalist sector was unable to absorb them, or even absorb some of the unemployed in the urban centers. As a result, because capital-intensive production did not require much labor, a different dichotomy became pronounced in the urban centres of these countries – that of formal versus informal economies."

The concept of dualistic economy was the foundation of Sir Authur Lewis' labour supply theory of rural-urban migration. He made a distinction between a rural economy with low-income and subsistence means of production sector, made up of surplus population; and a growing urban capitalist sector. According to Lewis, urban economy absorbed labour from rural areas and in the process hold down urban wages until the rural surplus is exhausted.

The concept of development in dualism revolves around the concentration on and expansion of the modern sector, and the suppression of the traditional sector assuming that the trickle down effects will reduce and abolish dualism at the end. While agriculture provides the labour and other resources, as well as capital for growing the modern sector, different strategies are adopted with some assuming that a decline in agricultural labour force due to pervasive disguised unemployment would not reduce agricultural production. The contention, is that useful deployment of these labourers in the modern sector, would lead to a rise in total productivity of the economy. This brings about the necessity to accord priority to investment in the modern sector. It is also argued that concentration in the modern sector brought about a rise in regional disparity, rural urban migration, urban unemployment, a decline in agricultural production, and hindrance to industrial development. This is due to low purchasing power among the rural dwellers as the anticipated trickle-down effects hardly ever happened. Generally, this line of thinking led to failures in development plans in many developing countries.

Over the years, international dimension was added to economic dualism with Singer (1970) defining economic dualism as the existence and persistence of increasing divergence between the rich and poor nations and rich and poor people on various levels. Earlier, Cameron (1967) had shown how the financial system of the developed countries evolved over time during the early stages of industrialization. The formal financial system, he noted evolved from various rudimentary stages (which can be referred to as the informal units). The idea was that as the formal financial institutions grew, they absorbed the informal units. This however, was not the experience in developing countries including Nigeria where the coexistence of the two sectors is chronic and non-transitional with the size of the non-banking public as well as participants in the informal outlets being on the increase rather than shrinking as was the case in developed economies. In fact, the interrelationship between the formal and informal financial institutions are such that the informal units do little or nothing to connect to the formal institutions, while the gains from the formal units hardly trickle down to the informal units.

To many authors, the coexistence of a dual financial system is a symptom of economic dysfunction (Webster and Fidler, 1996). A major observation in such an economy, is that informal financial institutions tend to have few vertical links with the formal financial institutions, and weak horizontal link among other informal institutions due to their poor specializations. It is rare to see them have any contacts with foreign markets nor intermediate between savers and the borrowers in such jurisdiction. At best, their mode of operation has been described as parallel rather than integrating units. It has therefore become increasingly costly and difficult for any economy in the face of increasing world globalization and financial integration, to sustain and tolerate this type of financial ‘disconnectedness’. Although development theorists are of the view that the potency of informal sectors serves as shock absorbers in developing economies by reducing the periodic impact of economic contraction, this can only be effective in the face of proper linkage between the formal and the informal sectors, such that the existence of informal units serve as training grounds for prospective managers of the formal institutions.

SECTION THREE

Dualism in Economic Development

Typically, a dual economy consists of two sectors: a small urban-industrial and a big rural-agricultural sector. The manufacturing sector displays features of a modern industrial economy, while a much bigger agricultural sector surrounding the advanced one is characterised by a primitive mode of production. As a result, labour market is split into two parts: one is comprised of relatively well-paid and skilled urban workers and the other, of poorly paid and low-productive rural workers. Based on Furnivall (1948); Boeke (1953); Jorgenson (1961), the original models laid emphasis on a single feature of dualism, which is behavioural or technological parameter differences between sectors, which produce the single commodity or are characterised by identical demand and demographic parameters. Multi-dimensional approaches were later adopted by scholars.

Lewis (1954) is credited with the pioneering work on rural-urban migration. This framework is of the view that the backward rural sector is the supplier of cheap labour to the advanced industrial sector and rapid capital accumulation in industry that drives growth depends on savings. The argument of Lewis (1954) is that "the central problem in the theory of economic development is to understand the process by which a community, which was previously saving and investing 4 or 5 percent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 or 15 percent or more".

In his later writings, Arthur Lewis explained his inclination towards economic dualism by pointing at a historical puzzle. According to him, "In Britain, during the first fifty years of the industrial revolution, real wages remained more or less constant while profits and investment were rising. This is against the neoclassical prediction that all three variables should move together". Clearly, Lewis' concept of dual economy is rooted in the classical approach of Smith and Ricardo, according to which there is a virtually 'unlimited supply of labour' that keeps wages low and profits high (Lewis, 1992).

A micro-foundation framework was provided to the Lewis model by Ranis and Fei (1964) which reformulated it in a neoclassical fashion by considering the case where unlimited supply of labour is over and the agricultural sector is fully 'commercialised'. The commercialization of the traditional sector results in the elimination of dualism (Fei and Ranis, 1961; Jorgenson, 1961). Other formulations (Boeke, 1953; Baldwin, 1966; Eckhaus, 1955; Higgins, 1956) considered diminishing—and not disappearing—differences in production conditions through time that result in the mere attenuation of dualism. Higgins (1956) argues that "dualism cannot fully elapse since 'some degree of dualism exists in virtually every economy. Even the most advanced countries, such as Canada and the United States, have areas in which techniques lag behind those of the most advanced sectors, and in which standards of economic and social welfare are correspondingly low'. This conception, however, emphasizes the simultaneous presence of well-performing and poorly-performing sectors, reflecting different stages of their development as the economy evolves."

SECTION FOUR

Dualism and Financial Sector Development

Unlike the popular perception, finance does not only imply credit provision, but also the accumulation of savings. For credit and savings to be useful, both have to be interconnected through a system. That system is referred to as financial system and involves the conversion of savings into credit as a result of bringing together those economic agents or units that are ready to postpone the consumption of their current incomes to the future and those that want to spend their future earnings now. Where the various savings and credit flows between these economic agents are recognized, controlled and legally backed by laws of a particular country or region, the process is formal and the system supporting them is called the formal financial system. The key argument in the formal system is that an aggrieved party can seek legal redress when unsatisfied with a particular transaction. On the other hand, when the flow of savings and credit is through unrecognized, uncontrolled systems with no legal backing, this is referred to as informal and the system through which they flow is called the informal financial system. The coexistence of both the formal and informal systems in a country or region makes the financial system to be described as dualistic.

It is important to state that financial dualism is a subjective issue because formality and informality are relative concepts, and placing clear cut boundaries between them is hard. This is because in between them are savings and credit flows via formal financial systems that are neither formal nor informal. This middle ground is referred to as semi-formal financial sector (SFFS), and is not controlled by specific regulations that direct the activities of the formal financial sector. What is important, however, is that its activities are legally enforceable with aggrieved parties finding legal redress to their problems. It is a generally held belief that the financial sector of the low income countries are dualistic, its size is large and has inhibited a number of developments in the sector. Arising from being ignored, neglected or assumed, the role of informal financial sector in serving the majority, who are faithful to it, has often fallen short of its goals.

The existence of financial dualism is basically hinged on two strands of arguments. In the first instance, informal financial system exists as a response to the formal financial sector's (FFS) shortcomings and excessive regulation. The second argument is that informal financial sector results from the dualism of the economies of LICs. There are other factors too that explain financial dualism but we are going to discuss the two strands of argument.

4.1 Response to Deficiencies of the Formal Financial Sectors and Excessive Regulation

This view opines that financial dualism results from the deficiencies and inefficiencies of the formal financial sector, and its close regulation, which have made it too urban, too bureaucratic, too regulated and too rigid (Germidis, et al, 1991) to supply financial services that the majority in LICs demands. The proponents, who are the defenders of financial market liberalization (McKinnon 1973; Shaw 1973; Fry 1988; Adams, Graham and Von Pischke 1984) and more recently the Ohio State University group amongst others, contend that on a macro-scale, the monetary and financial policies pursued by many LICs are not suitable and might have fuelled financial dualism. These policies according to Shem and Atieno (2001), which include interest rate controls, confiscatory reserve requirements, overvaluation of the domestic currency, credit subsidies, e.g., via credit issued at below market interest rates and mandatory selective credit allocation, excessive restriction on market entry, etc., led to "financial repression." The outcome was close regulation of the financial system and restrictions on activities of the financial institutions whose activities were either taxed or subsidized, distorted functioning of the market, misallocation of financial resources, slowdown of investment due to lower or excessively unstable returns and consequently, discouraging the development of financial institutions and instruments (Gonzalez Vega and Chaves 1994). In all this, the outcome was dualistic financial markets. A closer look at some of the restrictive policies will help to clarify this strand of argument.

4.1.1 Interest Rate Controls

The idea behind the imposition of interest rate controls was to improve access to credit and encourage investments by maintaining low interest rate. This was done directly by charging below market rates of interest on loans, or indirectly by paying low rates of interest on deposits, since it is assumed that financial institutions which obtain credit cheaply will be able to advance loans cheaply too. However, lower deposit rates of interest that do not reflect market rates, and which during times of high inflation become negative, discourage savings. In fact, as negative deposit real interest rates rise due to high and rising inflation, households become unwilling to hold money savings in financial institutions. They demand rather, inflation hedges, e.g., cattle, real estate, commodities, etc., which in general, yield quite low rates of return and pay, according to Vogel (1984b), "an inflation tax on any cash or deposits held for current obligations." Other informal savings arrangements come into play too, resulting in fragmented financial markets.

On the contrary, lending rates controlled below the market lead to credit rationing by the financial institutions. Credit becomes cheap and creates excess demand in the market. However, the institutions can neither raise interest due to the excess demand nor charge a risk premium equivalent to the risks of projects they finance, because of the officially administered rates. Lending institutions, therefore, resort to credit rationing by squeezing out the most costly, the most risky and the least influential borrowers (Vogel 1984a). Such borrowers, denied access to cheap loans, turn to the informal financial sector.

Low income countries employed this credit rationing policy, with sober intention, to avail cheap credit to small scale farmers and non-farm entrepreneurs without access to formal financial system credit. The outcome was that it mainly improved the access of large scale farmers and entrepreneurs to the loan portfolios of the formal financial sector. This encouraged them to take up more investments and therefore, more risk. But it limited small-scale farmers and entrepreneurs' accessibility to the same, thereby adversely selecting investment projects, denying funding to some that would yield highest returns. This policy of the iron law of interest rate restrictions (Gonzalez-Vega 1984), concentrates the distribution of credit amongst the rich by excluding small scale borrowers from formal financial sector loans, effectively pushing them to the informal financial sector.

4.1.2 Selective Credit Allocation

Another restrictive policy instrument used in less developed countries to address the deficiencies of the formal financial system is selective credit allocation. Unequal development and distribution of wealth was blamed on formal financial institutions, especially banks' financial technology. The introduction of selective credit allocation was meant to rectify the situation by providing credit to the segment of the market that the formal financial system could not adequately catered for. This was done in two ways. In the first instance, sectoral lending targets were administratively set up for the financial institutions and they were compelled to direct a given percentage of their loans to specific government priority sectors, enterprises or borrowers (Von Pischke, 1991). In return, they were to be compensated by the government through lower minimum reserve requirements, lower rates of taxation, rediscount lines or interest rate subsidies, etc (Germidis et al 1991). However, the consequence was a restriction of funding to the non-targeted, non-priority sectors, enterprises or borrowers with subsequent rise in the cost of funds available to them. Indeed, many of them, especially the poor and small and micro enterprises (SMEs) who demand unsecured, small, non-cost effective loans, were pushed out of this credit market. The informal financial sector was as a consequence favoured to grow to fill the slot. Also, credit ceilings set for these institutions directed towards fulfilling the credit needs of the government priority sectors was capable of hampering their competition for savings. On attainment of the set limits, extra savings became idle cash balances that could not be transformed into credit. The rational response of the institutions was to stop their efforts of attracting savings, and this rendered potential savers to become unwanted customers and accordingly, they resorted to the informal financial sector for savings, which was done through high minimum deposits.

The second instance involved the establishment of specialized credit institutions whose purpose was to channel low-priced loans to priority sectors. Just like the first alternative, their goal was to improve accessibility of the priority sectors to credit, whose shortage or lack was assumed to be the bottleneck to their increased production. Accordingly, Development Finance Institutions (DFIs) were established in many countries in the 1970s and 1980s to achieve these objectives (Schmidt and Zeitinger 1996, Yaron et al. 1997). Nevertheless, the lessons learnt were disappointing as low rates of interest on loans discouraged savings mobilization, while at the same time, rationing out the vulnerable borrowers (Thillairajah 1994 and Adams 1998). Thos people that were rationed out were left with no alternative than to turn to the informal financial sector for transactions. Diaz-Alejandro (1985) summed it up aptly that in Latin America "development banks created to solve one form of market failure, led to another one, i.e., a segmented financial market".

It emerged, however, that the failure of the policy of development finance institutions led to the emergence of a new one. Citing unnecessary bureaucracy in government, the donor community which earlier supported the DFIs abandoned it for non-governmental organizations (NGOs). Still, the policy was as before directed at channeling subsidized loans to priority sectors (Shylendra, 1995) but without involving the government. The lessons learnt were no different with notable failures of most credit programmes that accumulated large loan defaults (Thillairajah, 1994). According to Shem and Atieno (2001), targeted subsidized credit to priority sectors either through formal financial sector institutions, government owned development finance institutions or donor supported non-governmental organizations, promoted the fragmentation of financial markets of less income countries.

4.1.3 Minimum Reserve Requirements

This is another monetary policy tool that has also been used globally to ensure the stability of the banking system and to check money creation. Minimum reserve ratio in developed countries lies between 10-15% to total bank deposits and according to Germidis, et al (1991), it could be as high as 50% in less income countries. With the imposition of such high rate of reserve requirements, the domestic banking system is compelled to finance public debt and thereby crowd out other needy borrowers. With this policy, savings mobilization by the banking system is discouraged. In order to avoid this, banks are motivated to pay negative real interest rates on deposits and this discourages potential savers from saving with them. Incidentally, they turn to other forms of savings arrangements such as informal financial system, thereby fragmenting the financial system.

4.1.4 Minimum Account Balances

It is also not uncommon for minimum account balances to be used by banks to discourage savings. According to World Bank (1989), high minimum deposit requirements are usually beyond the majority of the working poor and small, medium-scale enterprises, who, given their usually small money balances, reflective of very low incomes in less income countries, demand deposit facilities that can accept their small deposits which formal financial sector institutions find expensive to provide. These requirements effectively deny them the services of the leading banks, and most of the savers crossover to the informal financial sector with the intention of acquiring affordable financial services. This analysis is predicated on the school of thoughts that in a financially repressed formal financial system, there is a reduced incentive for the formal system to attract new clients. The consequence is that the unenticed customers turn their attention to the informal financial system arrangements. Thus, financial dualism is a reflection of an over-regulated formal financial system, which cannot adjust accordingly to the conditions prevailing in most parts of less income countries.

4.2 Response to Dualism of Economies of Developing Countries

The financial sector segmentation is seen as resulting from the dualism of the economic and social structures of less income countries' economies with the result being informal financial system. The following are some of the aspects that describe economic dualism in these countries.

4.2.1 Illiteracy

The chunk of the population of most of these LICs, especially those in the rural communities, are not well educated and these create weak linkages between them and the formal financial sector institutions for which the latter bears no responsibility. A study conducted in a rural Kenyan district - Siaya, showed that 72.7% of sampled respondents participated in informal financial arrangements, a finding partly attributed to the high degree of illiteracy in rural areas. The study further showed that the popularity of informal financial sector participation was much stronger amongst the females with 89% sample participation compared to 49% for males (Ouma 1991). The results showed further that being a female enhanced significantly the likelihood of informal financial sector participation. This outcome was attributed to, amongst others, a relatively higher level of illiteracy amongst the females. The need for literate and numerate customers by formal financial sector cannot be downplayed since both parties need to document their transactions in writing. According to Shem and Atieno (2001), illiteracy easily deters potential customers from using the services of these institutions, since they often feel intimidated by the personnel and complicated bureaucratic procedures of these institutions - which demand a given level of literacy to be comfortable with.

4.2.2 Transportation and Communications Network

Germidis, et al (1991) are of the view that poor transportation and communication networks in less income countries also hinder formal financial sector expansion. Although it is not its responsibility to provide these infrastructural services, the formal financial sector often uses it to partly explain its institutions' urban concentration and consequently, the widespread use of informal finance in rural areas. In comparative terms, the network of transportation and communication in urban areas are better developed and the likely operations in rural areas incur high transportation and communication costs. Thus, the location of formal financial sector in rural areas is discouraged at the expense of their concentration in urban areas, thus the informal financial sector is dominant in the rural areas.

4.2.3 Concentration Centres of Economic Activities

In much of the low income countries, the concentration of economic activities at certain locations has equally been used to explain the relative high density of formal financial sector in those locations. Within such locations, there exist huge demands for financial services, which formal financial sector institutions seek to meet while generating profits. Areas with little economic activities, therefore, have fewer formal financial sector institutions. Consequently, most of the financial needs of people in those areas are met by the informal financial sector.

4.2.4 Inadequate Distribution of Social Services

The provision of social services, if any, such as schools, hospitals, entertainment and even public administration, in most of the low income countries, are concentrated in urban centres. This, in turn, generates a high demand for financial services and naturally, the formal financial sector institutions, motivated by profit, will be attracted to those areas. On the contrary, rural areas where most of the social services are not provided will be left to be serviced by the informal financial sector because there is no incentive for the formal financial sector institutions to operate in those areas.

In the circumstance, which is a reflection of structural rigidities found in low income countries, financial market segmentation is not due to inefficiencies of the formal financial sector or excessive regulation, but a result of economic dualism of their economies. Thus, the economic dualism experienced in low income countries perpetuates itself into the financial sector.

Other explanation of financial dualism as a result of the dualism of economies of developing countries, include imperfect information with poor information, leading to financial market segmentation, transaction costs which is high within the formal financial sector institutions but low in informal financial sector institutions, which rely on personal knowledge of their customers to drastically cut down on their information costs. Others are collateral, which is lacking among the poor households and small, medium-scale enterprises makes, and their participation in formal financial sector difficult with a recourse to informal financial sector. Also poor contract enforcement occasioned by weak law enforcement mechanism dissuade the formal financial sector institutions from advancing loans whose prospects of repayment look gloomy. Financial dualism also results from the absence of or weak insurance schemes, adverse economic environment and government inaction.

SECTION FIVE

Nigeria's Dualistic Financial System

The Nigerian financial system, though divergent over the years, has remained particularly dualistic with a side by side existence of formal and informal sectors. Despite series of reforms by the monetary authority to reduce the size of informality, available projection shows the existence of a large chunk of informal sector, which has both merits and demerits depending on the focus of analysis. The formal sector is dominated by the deposit money banks while a number of small but varied local units take charge of the informal sector. A key observation is that these two sectors have continued to exist independently, primarily as a result of the absence of an operationally inherent productive linkages, price and quantity setting. This is because the formal sector has failed to create a healthy and competitive environment to stem the increase proliferation of additional informal units. Just as economic duality failed to absorb the excess labour supply from the traditional sector as espoused by the Lewis model, but consequently brought about movement to the urban areas with the formation of formal and informal sectors, the formal financial sector could not absorb the informal financial sector because their mode of operation is parallel to each other. Within the formal sector, the procedures for cost of funds and lending are not competitive, whereas there exist a seamless quick and easy to access procedures in the informal units. This has been one of the hindrances made possible by the formal sector, which provides the motivation to ensure the emergence of new informal units, and the sustenance of dualism in the financial sector in Nigeria.

As in other less developed and developing countries, Nigeria is one of those countries where deep and persistent economic dualism subsists, with the coexistence of two seemingly parallel financial system, the formal and informal units existing side by side with little or weak linkage, and sharing the market in a manner similar to that of oligopolistic competition. As observed by Ofonyelu (2014), the two units are such that they are characterised by different levels of development, technology, patterns of patronages, and more importantly by interest rate (price) setting. While many sectors of the economy also exhibits one form of dualism or the other; the extent, dimension and persistence of the phenomena in the financial system calls for further research attention.

The formal financial institutions are made up of the deposit money banks as well as the micro-finance banks which are all involved in mobilizing funds and creating credits in the economy. On the other hand, the informal financial institutions include the local credit institutions, unions and associations, and are mainly patronized by local petty market traders, artisans and many others for pooling and extending credits. The informal group operates at the lower end of the market and is usually developed towards satisfying specific financial needs of its members. In line with the principle of know your customers, the close contact enjoyed by the participants in this group give their operators the basis to extend loans and other financial services without collateral requirements and with little or no elaborate documentations. Despite the upsurge and increasing competition among the banks, these informal financial outlets have remained resilient and prominent. It is however contended that lax regulatory control and restrictions to entry and exit into the industry has allowed for their increased proliferations in the informal sector.

Recent views have focused on complementary roles performed by the informal financial units (Mallik, 2007; Wickramanayake, 2004; Daniel and Kim, 1992; Taylor, 1983) especially in the developing countries. The provision of credit by the informal sector at cheaper costs and greater flexibility than the formal sector has increased their patronage among the poor and the middle income groups and continue to allow for its continued growth and increasing proliferations in the industry. Indeed, in many developing countries, more capital is usually being held in the informal economy than the formal economy (Sanusi, 2002). This presents daunting challenge to monetary policy implementation and effectiveness. Attempts at integrating the numerous informal units into the formal sector have become a perpetual challenge to increasing savings mobilizations and its efficiency in Nigeria.

SECTION SIX

Conclusion

This paper discussed issues on economic dualism in terms of the concepts of dualism in economic development and Nigeria's dualistic financial system. The assumption of economic dualism revolves around the splitting of the social and economic structures of various sectors, to differentiate them in terms of organization, level of development as well as goal structures. Typically, two sectors of the economy are distinguished within the concept of economic dualism. These are the capital intensive modern industrial and plantation agricultural sector, which are involved in the production for the global market, with a high level of division of labour; and traditional small scale subsistence sector, along with handicraft and petty trading and high labour/low capital intensity and limited division of labour.

The outstanding feature, is that the two sectors have little relation and interdependence with each other, but each grows according to its own strength. In general, the modern sector represents the economic interest of the advanced economies and its multiplier and growth effects benefit them with little or no effect on the domestic economy.

Bibliography

Adams D. W. and Fitchett D. A. (1992). Informal Finance in Low Income Countries. Westview Press, Boulder.

Adams D. W. Graham, D.H. and Von Pischke, J.D. (1984). Undermining Rural Development with Cheap Credit. Westview Press, Boulder and London.

Baldwin R. E. (1966). Economic Development and Export Growth: A Study of Northern Rhodesia, 1920–1960, Los Angeles: University of California Press.

Boeke J. H. (1953). Economics and Economic Policy of Dual Societies, New York: Institute of Pacific Relations.

Cameron R. (1967). Banking in the Early Stages of Industrialization.*Oxford University Press*, New York.

Diaz-Alejandro C. (1985). Good-Bye Financial Repression, Hello Financial Crash. In: *Journal of Development Economics*, Vol. 19, pp. 1 - 24.

Daniel B. C. and H. Kim (1992). Alternative Rationale for Financial Dualism: Note.*Journal of Money, Credit and Banking*, 24 (4): 570-577.

Eckhaus R. S. (1955). The Factor Proportions Problem in Underdeveloped Areas. *American Economic Review*, No. 45 (September 1955), pp. 539–565.

Fei J. S. and Ranis G. (1964). A Theory of Economic Development. *American Economic Review*, 51: 533–565.

Fields G. S. (1975). Rural Urban Migration, Urban Unemployment and Job Search Activity in LDCs. *Journal of Development*.

Fry J. M. (1988). *Money, Interest, and Banking in Economics*. Johns Hopkins University Press, Baltimore.

Furnivall J. S. (1948). *Colonial Policy and Practice*, Cambridge: Cambridge University Press.

Germidis D., Kessler D. and Meghir R. (1991). Financial Systems and Development: What Role for the Formal and Informal Financial Sectors? Development Centre Studies, Organisation for Economic Co-operation and Development (OECD), Paris.

Ghate P. et al. (1992). *Informal Finance: Some Findings From Asia*, Oxford University Press, Hong Kong.

Gonzalez-Vega C. and Chaves R. A. (1994). Principles of Regulation and Prudential Supervision and Their Relevance for Microenterprise Finance Organisations. In Otero, M. and Rhyne, E. (eds), *The New World of Microenterprise Finance: Building Healthy Financial institutions for the Poor*, pp.55-75, Kumarian Press, Connecticut.

Gonzalez-Vega C. (1984). Credit - Rationing Behaviour of Agricultural Lenders: The Iron Law of Interest - Rate Restrictions. In Adams, D.W., Graham, D.H. and Von Pischke J. D. (eds.), *Undermining Rural Development with Cheap Credit*, pp. 78-95, Westview Press, Boulder and London.

Higgins B. J. (1956). The ‘Dualistic Theory’ of Underdeveloped Areas, *Economic*

Development and Cultural Change, No.4 (January 1956), pp. 99-115.
Harris T., & Todaro, M. (1970). Migration, Unemployment, and Development: A Two Sector Analysis. *American Economic Review*, 40, 126-142.
Hosseini H. (2012). Arthur Lewis' Dualism, the Literature of Development Economics, and the Less Developed Economies. *Review of European Studies*; Vol. 4, No. 4; 2012
Jorgenson D. W. (1961). The Development of a Dual Economy. *Economic Journal*, No. 71 (June 1961), pp. 309–334.
Kirkpatrick C. and Armando B. (2004). The Lewis Model after 50 Years. *The Manchester School*, 72(6), 679-690.
Lewis A. (1954). Economic Development with Unlimited Supplies of Labor. *The Manchester School*, 22, 139-191.
Lewis W. A. (1992). Autobiography, in Lindbeck A. (ed.) *Nobel Lectures: Economic Sciences1969 –1980*, Singapore: World Scientific Publishing.
Mallik R. (2007). Endogenous Formation of Financial Dualism. *Hitotsubashi Journal of Economics*, 48: 137-158.
McKinnon R. I. (1973). Money and Capital in Economic Development, Brookings Institution. Washington D. C.
Ofonyelu C. C. (2011). Dualistic Financial System: Why an End May Not be Near in Nigeria.
Ouma A. R. S. (1991). Informal Financial Sector in Kenya: The case of Siaya District. Unpublished M. A. Thesis, Kenyatta University.
Sanusi J. O. (2002). Savings Management in Developing Countries. An address presented at the Banking and Financial Services Symposium organised by the Common Wealth Business Council, London.
Schmidt R. H. and Zeitinger, C.P. (1996). The Efficiency of Credit - Granting NGOs in Latin America. In: *Savings and Development*, Vol. XX, No.33, pp. 353-382.
Shaw E. S. (1973). *Financial Deepening in Economic Development*, Oxford University Press, New York.
Shem A. O. and R. Atieno (2001). Financial Dualism and Financial Sector Development in Low Income Countries. *Savings and Development*, Vol. 25, No. 4.
Shylendra H. S. (1995). Lender Vitality and Lender Behaviour - A Case Study of a Regional Rural Bank in South India. In: *Savings and Development, Quarterly Review* - Vol. XIX, No.2, pp. 231-242.
Singer H. W. (1970). Dualism Revisited: A new approach to the problems of dual societies in developing countries", *Journal of Development Studies*. 7: 60 61.
Taylor L. (1983). *Structuralist Macroeconomics: Applicable Models for the Third World Countries*. Basic Books, New York.

Thillairajah T. (1994). Development of Rural Financial Markets in Sub-Saharan Africa. *World Bank Discussion Papers, Africa Technical Department Series 219*, World Bank, Washington, D.C.

Vogel C. R. (1984b). Savings Mobilisation: The Forgotten Half of Rural Finance. In Adams, D. W. Graham D. H. and Von Pischke J. D. (eds.), *Undermining Rural Development with Cheap Credit*, pp.248-265,Westview Press, Boulder and London.

Von Pischke J. D. (1991). Finance at the Frontier: Debt Capacity and the Role of Credit in the Private Economy, *EDI Development Studies*, World Bank, Washington, D.C.

Webster L. and P. Fidler (1996). The Informal Sector and Microfinance institutions in West Africa" *Regional and Sectoral Studies*, The World Bank.