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Nigerian exchange rate administration under the structural adjustment programme.

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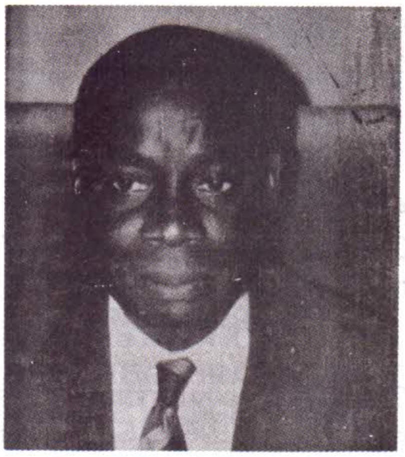
NIGERIAN EXCHANGE RATE ADMINISTRATION UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME

INTRODUCTION

Exchange rate is defined as the domestic price of foreign money, i.e., the units of the domestic currency that will purchase a unit of a foreign currency. One of the immediate consequences of the role of exchange rate as a price is that it links together the general price level in the domestic economy with that of other countries, thereby providing information on what to produce and what to consume amongst countries that trade together. This makes monetary authorities to always strive to achieve realistic and fairly stable exchange rates for their national currencies so that the rates may serve as an efficient resource allocation instrument. To be successful as a policy instrument, the exchange rate must provide sufficient incentive to exports and the production of local substitutes for imports. On the other hand, it must provide sufficient disincentive to import and capital flight.

The influence of exchange rate as a price that links the general level of prices of trading partners could be immediately seen through price inflation. Suppose the home country experiences higher inflation than its trading partners and leaves its exchange rate unchanged. Over time, its exports and imports-substituting products will became uncompetitive. In other words, its exports will assume higher prices than those of other countries' exports in the world market, while her imports will become cheaper than the domestically produced substitutes. If this situation is allowed to persist, a balance of payments crisis will emerge as more imports would be demanded than her exports are demanded abroad. A depreciation of the currency would be called for in order to restore the previous relationship of favourable balance of payments. This shows that the exchange rate is a very important price in the economy, influencing all areas of economic activity.

In practical terms, what determines the external value of the domestic currency is the foreign exchange earnings and expenditures of a country. In a free-floating exchange rate system the exchange rate is determined at a point where the supply of and demand for foreign exchange are equalised. As much as possible, however, monetary authorities try to influence the values of their currencies through the adoption of appropriate macroeconomic policies that ensure fiscal discipline and avoid excessive monetary expansion. If currency depreciates very highly due to inappropriate policies, the prices of all exports and imports will change. The relative prices of both traded and non-traded goods will also alter, unleashing a series of repercussions on the welfare of the people. Similarly, a wide and persistent fluctuations in the exchange rate often result in foreign exchange speculations that may aggravate balance of payments difficulties. Under this condition, exporters/importers are



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unable to make sound estimates of appropriate prices for their products. Investors, lenders and borrowers are subject to exchange risks which may lead to financial losses.

These and other considerations have influenced the management of the exchange rate of the Nigerian currency since the beginning of our nationhood. The adoption of any exchange rate regime has been made with due regard to Nigeria's domestic and external economic circumstances.

The aim of this paper is to briefly review the administration of Nigeria's exchange rate policy since the inception of the market-determined exchange rate system. The discussion is organised in four main parts. In Part I, exchange rate administration before the introduction of the Structural Adjustment Programme (SAP) in July 1986 is briefly reviewed in order to provide the necessary background for adopting the market-determined system under SAP. Part II is devoted to the analysis of the structure of the foreign exchange market

(FEM), while Part III provides a brief explanation on why the naira exchange rates have not been stabilised since the beginning of FEM.

Part IV contains the summary and conclusion.

PART I
A BRIEF REVIEW OF EXCHANGE RATE ADMINISTRATION PRIOR TO THE INTRODUCTION OF THE STRUCTURAL ADJUSTMENT PROGRAMME

The exchange rates of Nigeria's currency during 1960 – September 1986 were administratively determined. The determination involved various methods, ranging between a fixed attachment of the currency to either the pound sterling or the United States dollar, a system of independent floating, and the use of a basket of currencies, depending on the domestic and global economic situation.

From independence in 1960, the Nigerian pound was retained at par with the British pound sterling which exchanged for US$2.80 up to November 1967 when sterling was devalued (See Table I). Nigeria did not devalue her currency with the pound sterling in order to avoid the adverse consequences of devaluation. The decision was based on the fact that the effect of devaluation would not be as beneficial to the Nigerian economy as it would the British. For instance, it would not increase Nigeria's foreign exchange earnings through production expansion as the items were mainly primary products, the prices of which were determined abroad, while the resultant inflation from devaluation would be adverse to the domestic economy.[1]

However, the break-down of the Bretton Woods system, the so-called "gold exchange standard", in August 1971 and the subsequent devaluation of the US dollar on two occasions between 1971 and 1973, led to realignment of currencies world-wide. In January 1973, the naira became, the Nigerian national currency with half the value of the Nigerian pound. Like the US dollar, the naira was devalued by 10.0 per cent in February 1973 in consonance with world economic reality as it became obvious that the currency was becoming over-valued. This was done in order to curtail rapid rate of imports, encourage exports, protect domestic industries and prevent capital flight.

International developments continued to complicate exchange rate management as the major currencies were persistently floating, resulting in high global inflation. The policy of fixing the naira exchange rate to the US dollar was, therefore, discontinued in April 1974. From that time on the value of the naira was independently determined up to late 1976 when the system resulted in the appreciation of the currency, thereby encouraging excessive imports, and in the process, depleted the external reserves. Towards the end of 1976, the naira was, therefore, allowed to depreciate in order to reflect the country's economic situation. In that year, a balance of payments deficit of N241.6 million was recorded, against the surplus of N3.0 billion and N157.5 million in 1974 and 1975 respectively.

Various options of exchange rate determination were considered between 1974 and 1978 as external reserves management became complicated not only because of international exchange rates instability but because of foreign exchange malpractices which were fast depleting the reserves. In December 1974 Nigeria's external reserves stood at N3.4 billion, rose to N3.7 billion in 1975 but declined to barely more than N1.0 billion in 1978.[2] In reaction to this, the naira was devalued in June 1978 by 7.0 per cent and an import-weighted basket of currencies was adopted, using the currencies of Nigeria's seven major trading partners, for the determination of the exchange rate. Other variables considered in the final determination, however, included the level of reserves, the inflation situation and developments in international financial centres. At the beginning of 1979 the commercial policy instrument of exchange control was reinforced by the introduction of the Comprehensive Import Supervision Scheme (CISS).

Towards the end of the year, however, Nigeria experienced substantial foreign exchange earnings resulting from increased demand for crude oil consequent upon the Iran/Iraq war. Consequently, external reserves rose rapidly, from about N3.1 billion in 1979 to N5.5 billion in 1980. The improved situation made the new civilian administration pursue a more relaxed trade policy in the budget of 1980, an aspect of which policy was the appreciation of the naira aimed at

1 Central Bank of Nigeria, Research Department, *Twenty years of Central Banking in Nigeria, 1959–1979*, p. 172.

2. CBN Annual Report and Statement of Accounts for the year enede 31st December, 1978, page 82.

curtailing domestic inflation.

The new situation generated a lot of problems as the relaxed government policies were abused in various ways, including siphoning of funds out of the country with collusion with foreigners posing as suppliers of imports that were never received; false documentation of invoices and bills on services never performed. All this rapidly depleted the external reserves[3]. The fall in reserves assets was exacerbated by a glut in the crude oil market which began during the second half of 1981. This resulted in rapid fall in demand and prices of oil. Consequently, Nigeria's reserve assets persistently declined, reaching a mere N741.0 million at the end of 1983, an amount not enough to cover one month's imports which averaged N1000.0 million at that time. The exchange rate of the naira had to respond to the vicissitudes.

In 1982 the Emergency Economic stabilization Measures, otherwise known as the Austerity measures were introduced involving the restriction and prohibition of a wide range of imports of both industrial and consumer goods. The measures continued throughout 1983. In 1984, more stringent exchange control measures were introduced, including sectoral allocation of foreign exchange and tighter import licensing. Also, commercial and merchant banks were given discriminatory foreign exchange allocations which underlined the specialised functions of each category of banks in foreign exchange transactions. These policies were carried through to 1986. But the situation did not significantly improve despite increasing trade and payment controls. The structural adjustment programme was, therefore, introduced in 1986 as the most viable option for revitalising the economy.

The effect of the above situation on the naira exchange rate can be summarised as follows: The Exchange rate was stable at N0.7143 = US$1.0 from 1960 to 1970. As a result of the collapse of the Bretton Woods arrangement, the stability was disturbed in 1971, making the currency to appreciate consistently reaching N0.6077 = US$1.0 in July 1975 when Nigeria was receiving substantial inflow of foreign exchange from crude oil export. The reserves declined in 1976 and a deficit balance of payments was recorded, causing depreciation of the naira to an average of N0.6265 = US$1.0 and N0.6467 = US$1.0 in 1976 and 1977 respectively. The value of the currency thereafter improved, reaching the highest peak of N0.5314 = US$1.0 in October 1980. From 1981, however, the naira depreciated persistently arising from the change in Nigeria's fortune in the depressed crude oil market. The Central Bank continued to make efforts to appropriately adjust the value of the currency. From various estimates carried out, it was established that the naira was highly over-valued.[4] The value of the currency was, therefore, adjusted downward consistently. On the average, the naira was depreciated to N0.6729, N0.7247 and N0.7648 to the United States dollar in 1982, 1983 and 1984 respectively. As the situation became increasingly critical the pace of depreciation increased in 1985 and 1986 when the currency averaged N0.8938 and N2.0210 per dollar respectively. The more significant depreciation occurred in the last quarter of 1986 as a result of the adoption of the Second-tier Foreign Exchange Market (SFEM) in which the market forces of supply and demand largely operated.

PART II
EXCHANGE RATE ADMINISTRATION UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME[5]

As mentioned in the preceding part various austerity measures were introduced between 1984 and 1986 by the Government in the form of stringent control measures on the trade and payment system to bring about economic recovery. The measures were directly or indirectly meant to support the value of the naira. In 1986, the combination of persistent down-ward trend in receipts from crude oil, the bunching of external debt and the glaring inadequacies of exchange control and other measures left the naira highly over-valued. This and other price distortions in the economy necessitated the introduction of SAP in July, with the evolution of a realistic exchange rate and trade liberalisation as part of the main strategies.

The Foreign Exchange Market

As a core element in SAP, a foreign exchange market (FEM) was established. Initially in order to achieve a smooth transition, the

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3. Twenty Years of Central Banking in Nigeria, pp. 159–160.
4. See for example, the Report of the Presidential Task Force on the Exchange Rate of the Naira, 1986.
5. Federal Ministry of Information, *Structural Adjustment Programme, July 1986 – June 1988*, Lagos, 1986.

market was split into two-tiers.

First-tier Foreign Exchange Market

The first-tier was the extension of the system of administratively determined exchange rates which was being discontinued. As said earlier, the determination of the rate was mainly based on the basket of currencies of Nigeria's major trading partners. The rates on this market were rapidly depreciated. Transactions covered in the first-tier market were mainly transitional such as trade already covered by specific import licence and irrevocable letters of credit as well as those on which import duties were already paid; due debt obligation; contribution to international organisations and remittances for Nigerian diplomatic services abroad. The naira was progressively depreciated on this market so that on July 2, 1987, at the rate of N3.7375 = $1.0, the first-tier was merged with the second-tier foreign exchange market making the second-tier foreign exchange to become the Foreign Exchange Market.

The Second-tier Foreign Exchange Market

The Second-tier Foreign Exchange Market (SFEM) was set up as a central element of SAP for eliminating the over-valuation of the naira. The most important objective of SFEM was, therefore, to evolve a realistic market-determined exchange rate for the naira in order to reduce demand for foreign exchange to available supply and so reduce the pressure on the balance of payments. By implication, the evolved exchange rate would also eliminate the pervasive distortions in all the major sectors of the economy, reduce imports, stimulate exports and pave way to a more self-reliant and sustainable growth. All transactions, except the transitional ones mentioned above, were covered by the rates determined in this market.

At its inception on 29th September, 1986, the foreign exchange market (FEM) had two segments: *the official*, the bidding sessions of which are operated by the Central Bank; and *the second segment* which was the inter-bank/autonomous market where privately sourced foreign exchange was traded. In conformity with the liberalisation policy of SAP, Government took certain radical actions in 1986 strictly directed to making the new system work efficiently. The Second-tier Foreign Exchange Market decree, No. 23 of 1986 abolished exchange control and import and export licensing. Earlier, in another promulgation the erstwhile commodity boards were abrogated, thus privatising commodity exports. Exporters became owners of all their foreign exchange earnings which they could use to undertake eligible transactions, keep in domiciliary account in Nigeria, or sell outright to authorised dealers. The same applies to any other foreign exchange earners. Funds from private sources could be traded by authorised dealers amongst themselves; indeed, this was the main source of funding the autonomous market. But it is prohibited to use funds obtained from the Central Bank auctions for inter-bank transactions.

Organisation/Operation of the Market

A brief summary of the operational arrangement of the Market is as follows:

Essentially, the main issues concern the determination of eligible participants, periodicity of the market, method of determining the exchange rate, effective monitoring of its operations and funding. All these made for introducing a several measures meant to bring about orderliness and discipline, make foreign exchange available to users as widely as possible and introduction of incentives to attract foreign exchange from abroad.

(i) Participants in the Market

Participants in FEM are limited to licensed commercial and merchant banks who submit bids not on their own account but for their customers, the real users of foreign exchange. The market began in September 1986 with the participation of 34 commercial and merchant banks. The number of the banks rose steadily to 120 before the suspension of the issuance of licences for the establishment of new banks. Limiting participants to banks has the advantage of ensuring orderliness and moderating unkeen competition among firms in which only the big conglomerate multinationals would always succeed to the detriment of the small and medium-scale ones. It also ensures a more effective supervision regarding conformity to the regulations governing utilisation of the scarce foreign exchange resource.

In furtherance with the aim of making foreign exchange available to as many users as possible, the banks until the new policy statement of 5th March, 1992 were classified into various categories based on the size of their assets. Beginning with two categories of big and small banks, the authorised dealers were re-grouped into three, four and six classes with the assurance that a certain proportion of funds made available at the FEM would reach winners in all categories. Another underlying reason for doing this was to curb excessive bidding practices among banks which tended to influence the rates upward, i.e. depreciate the naira unnecessarily. Since 5th March, 1992, however, CBN foreign exchange sale to the banks is now without discrimination as regards any category.

(ii) Auction Session Periodicity

The periodicity of the auction sessions varied from the initial two-weekly, to daily and weekly sessions. These were influenced by practical considerations including the convenience of the authorised dealers and the continued search for the evolution of stable exchange rates. In the new policy, auction sessions are no longer conducted by CBN. Banks wishing to purchase/sell foreign exchange submit their bid/offer rates once a week to the CBN.

(iii) Exchange Rate Determination

The methods employed in the determination of the exchange rates have also been varied in order to achieve a more orderly bidding behaviour on the part of authorised dealers and to make for reasonable distribution of foreign exchange among users. The initial method of using the "average of successful bid rates" was discontinued after the first two bidding sessions as it tended to favour only a small number of banks that submitted the highest bid rates. The marginal rate, the rate at which the amount supplied the market is exhausted, was thereafter employed before it was replaced with the Dutch auction, whereby bidders buy foreign exchange at their quoted rates, which was introduced in order to inject a sense of discipline into the behaviour of bidders. The official exchange rates are now determined by the Central Bank in accordance with market situations.

(iv) Funding

At the introduction of FEM, the hope was that the private sector would become the major supplier of funds to the Market. This hope is yet to be realised. In other words, the Central Bank has been the main supplier of funds to the Market so far. The Bank supplied the Market with amounts totalling US$2304.7 million, US$2855.2 million and US$2172.4 million in 1987, 1988 and 1989 respectively, representing an average of 67.8 per cent. By comparison autonomous funds aggregated US$1082.6, US$1242.9 and US$1162.3 million. In 1990 and 1991, the Bank supplied the Market with US$2536.1 million and US$3146.5 million respectively, with US$1452.0 and US$1440.1 million from private sources. In sum, the Central Bank provided about two-thirds of the total foreign exchange utilised for FEM operations during the review period. This is not a stable situation, as by its very nature, a monopolistic foreign exchange market, comprising several competing buyers and only one major seller cannot be free of imperfections.

In order to encourage more private funding, several incentives have been put in place including the provision of domiciliary accounts where owners of foreign exchange can keep their funds and make use of them for eligible transactions. By and large, however, the currency remained unstable and persistently depreciated at the FEM for reasons including speculative behaviour of some dealers. At year-ends, rates of depreciation in the FEM were 19.9, 22.7 and 33.0 per cent in 1987, 1988 and 1989 respectively. The exchange rate of N9.8650 = $1.0 at the end of 1991 showed that the currency depreciated by 67.7 per cent from the exchange rate of N3.1828 = US$1.0 at the end of 1986. In 1992, the depreciation trend continued, reaching N10.5564 = US$1.0 at the beginning of March. The role which many operators play in contributing to the deterioration in the value of the naira made for the reform of FEM announced by CBN on 5th march, 1992. As a result of the new policy N18.00 traded for the dollar, beginning on the day of the announcement. Before dwelling on this, it will be necessary to briefly mention the other factors which have contributed to the difficulty of achieving exchange rate stability.

(v) Other Developments

(a) The autonomous market was merged with FEM into the Inter-bank Foreign Exchange Market (IFEM) in January 1989 in order to stamp out the emergence of multiple exchange rates with the attendant distortions in the economic system.

(b) Also, *bureau de change* was introduced in August 1989 to, among others, accord legal recognition to small foreign exchange dealers, provide free access to foreign exchange by small users with relative convenience, and to enhance the level of adequacy of information of foreign exchange flows. Only privately sourced funds can be traded in the bureaux.

It may be adverted at this point that the exchange rates of the bureaux had been more or less along the same line with the rates of the parallel market. (See Table 2). The bureaux operators see those of the parallel market as competitors for the same funds. With the averages of N10.13 and N10.53 to the dollar of the bureaux and parallel market respectively in 1989 and naira appreciated to respective rates of N9.65 and N9.61 = US$1.0 in 1990 and depreciated to N13.52 and N13.45 = US$1.0 in 1991. The average rates between January and March 1992 were N18.39 and N18.36 in the bureaux and the parallel market.

PART III REASONS FOR THE PERSISTENT DEPRECIATION OF THE NAIRA

The rate at which an economy responds to policy measures highly depends on its level of development and industrialisation. In a situation of currency depreciation, an economy with a dynamic export sector will more quickly show signs of recovery from recession, its exports becoming relatively cheap and highly competitive vis-a-vis the exports of other countries in the world market. With comparative cost advantage, its domestic import-substituting industries will also tend to be stronger as its products are relatively cheaper and so preferred to the more expensive imports. The deciding factor is price differentials between the domestic economic and its trading partners. In this case, any action which generates inflation in the domestic economy should be avoided if adjustment is to be achieved within a reasonable period of time. Expansionary expenditure such as government deficit financing through borrowing from the CBN and excessive credit creation are sources of inflation, especially when such expenditures are not in the highly productive sectors. As noted earlier, inflation by the fact that it raises the general price level of a country tends to adversely affect the value of the currency vis-a-vis the currencies of its trading partners with fairly stable domestic prices. Since domestic prices of goods and services increase relatively to those of the other countries, the goods and services of that country will become more expensive. Demand for her exports will, therefore, fall while domestic demand for imports would increase. In order to restore balance of payments equilibrium, currency depreciation will occur. Lastly, one of the most intractable sources of disturbance to any economic policy is the tendency to flout existing rules and regulations. This has been rampant in Nigeria and it is the main negative factor postponing the realisation of the objectives of well-intended policies, including the evolution of a stable exchange rate of the naira. The new foreign exchange policy was necessitated to deal with this issue.

These factors will now be discussed under three main sub-heads, namely, the nature of the economy, fiscal and monetary developments and elements of indiscipline.

(i) The nature of economy

One of the principal aims of SAP was to reduce dependence on the oil sector as the principal earner of foreign exchange. It is fairly obvious now that this aim is not yet achieved, as the share of crude oil in total exports amounted to 92.6 per cent in 1991. A principal reason for this is the nature of the economy: the nature of the production of non-oil export and the market conditions for their demand.

The spin-offs of the oil sector are very small for certain reasons. It is a primary extractive industry with the major part exported in crude form. It is wholly owned by the government and foreign companies; the mode of production is capital intensive and labour economising. All this means that the value-added is minimal and its contribution to local individual and industrial initiatives and gains are rather small and restrictive. The non-oil sector is the major sector where more people are engaged and where gains are more diversified in terms of income, local initiative and industrial development. At present, however, earnings from non-oil exports cannot increase within a short time for many reasons. First, the products are mainly primary commodities from trees, the production of which is highly inelastic. Immediate response to price incentives is, therefore, limited to merely tending the existing plantations better. Secondly, the demand conditions for the products are also not always favourable. Their prices are determined abroad and, more often than not, increasing production depresses the market. As there is limit to storage, prices have to fall very low in a good year if the market would be cleared. Resulting from the inelastic nature of production, farmers cannot easily switch their inputs away from products with depressed market conditions to those whose prices rise. Lastly, the agricultural products are highly susceptible to vagaries of weather, pests and other natural hazards, which often cause poor harvests.

Concerning manufactured and processed products, this sub-sector is very small, and very many of our industries are still highly dependent on foreign inputs and technology, resulting from the inappropriate policies of the 1970s and early 1980s which facilitated industrial establishments that depend highly on foreign inputs. Expansion of the output of the sub-sector, either for exports or import-substitution is, therefore, highly constrained. Even if we succeed in exporting some, the governments of developed countries to which much of the products will go usually see these category of our exports as competing with their domestic industries and so impose high tariffs and non-tariff barriers on them.

All this is not to say that Nigeria has not recorded some gains from SAP, especially during 1986–1987 when the FEM was not fundamentally disturbed by official intervention and excessive speculation of some foreign exchange dealers. It is only meant to say that non-oil exports have not yet expanded as fast as earlier hoped for the reasons mentioned above. For instance, Nigeria's major agricultural exports, the main non-oil export sub-sector rose from a share of 4.6 per cent of total exports in 1986 to 5.2 and 5.7 per cent in 1987 and 1988 respectively (See Table 3). Since 1989, however, commodity prices have been falling, making the share of non-oil exports in total exports to fall to 3.0 and 2.6 per cent in 1989 and 1990 despite the appreciable increased quantity in 1990. The share of manufactures and processed goods fell from 0.6 per cent in 1986 to 0.2 per cent in 1989 and 1990. As regards foreign exchange earnings on the products, it will be observed that receipts from non-oil exports actually increased in response to the incentives contained in the SFEM decree, especially as exporters are permitted to retain their proceeds 100.0 per cent. Thus, from US$388.0 million in 1986, earnings increased to US$537.1 million in 1987 and US$611.9 million in 1988. Resulting from dampened demand in the world market, US$400.0 million and US$405.8 million were recorded in 1989 and 1990 respectively.

The lesson to learn from this analysis regarding the constrained nature of production of non-oil exports is that unless the country experiences a surge in foreign exchange inflow from some other sector, it will take a little more time before substantial result can be achieved from that sector. The present policies aimed at reviving domestic production should be continued and reinforced if we are serious about achieving economic viability. Discontinuance of SAP or its exchange rate system will only draw back the development process. If SAP had been introduced in 1982 instead of the "Austerity Measures" of April of that year the pains could have been less. Government should only ensure that contradictory actions to the success of SAP are not allowed.

(ii) **Fiscal and Monetary Developments**

(a) **The influence of government expenditure**

FEM operations in 1987 was relatively successful, indeed it has been the most successful year so far for SAP and FEM when on the average N4.0719 exchanged for the US dollar. In that year, the rate of increase in Nigeria's non-oil export earnings was highest, from US$388.0 million in 1986 to US$537.1 million, up by 38.4 per cent. Inflation rate was relatively low at 10.2 per cent (See Table 4). Both industry and individuals accepted the challenge of inward-looking for sourcing industrial raw materials for the attainment of self-reliance. Export producers redoubled their efforts and several new products, including handicraft, entered the export list. Nonetheless, during the year complaints were loud and persistent as the pains of adjustment started to show.

In the budget of 1988, therefore, the Federal Government decided to ease some of the apparent pains by introducing a reflationary budget, with general upward adjustment to salaries. This implied substantial increase in government expenditure. Beginning in February, the autonomous market became over-patronised, leading to a rapid depreciation of the naira in that market and the emergence of multiple exchange rates between that segment and the official market. Indeed, for some time, before moral situation prevailed, exchange rates gap/margin between FEM and autonomous market was wider than that between FEM and the parallel market.

Since 1988, government expenditure has been on the increase because of growing social and economic commitments. Deficit financing has also been rising. The deficit which amounted to N8.2 billion in 1986 fell to N5.9 billion in 1987. It, however, rose thereafter to N12.2, N15.3 and N23.4 billion in 1988, 1989 and 1990 respectively. The deficits rose to N35.3 billion at the end of 1991. When related to the GDP of those years, the budget deficits were 10.4, 5.3 and 8.5 per cent in 1986, 1987 and 1988 respectively. In 1989, 1990 and 1991 budget deficits represented 7.9, 8.0 and 12.4 per cent of the GDP of the respective years. In an economy so heavily dependent on imports, the adverse effect of these deficit financing on the value of the naira has been serious because a large portion of expenditure normally goes for imported items. This is the major source of instability in the value of the naira.

(b) Private Sector Expenditure

Private sector has also in some ways contributed to monetary expansion. The private sector was not untouched by the influence of the reflationary budget of 1988. Government contractors would normally revalue their contracts upwards. Also, workers in the sector got substantial increases in salaries and allowances even more than those in the public sector. Government contractors constitute an important group of importers and they always embark on extensive importation as most of the materials used in construction are in short supply in the domestic economy. In this case, government expenditure feeds into private sector expenditure which in this way brings considerable pressure on the naira in the FEM. Moreover, the private sector contributed to monetary expansion in another way which did not help the naira in the FEM. In reference here was the practice by banks and some non-bank financial institutions which used to accept foreign assets as collateral for granting naira loans without bringing in any funds up till 1989. This practice contributed to rapid monetary expansion and the result was adverse to naira exchange rate stability. The Central Bank had to prohibit the practice in April and May 1989.

3. Elements of Indiscipline

The FEM was designed with certain institutional and regulatory measures which must be observed so that its objectives may be attained. In observing the rules, discipline is fundamentally of necessity. Indiscipline creates diversion from set objectives. Just as malpractices thwarted the erstwhile exchange control objectives, in the course of operating FEM, indiscipline has prevented the evolution of a stable exchange rate.

Some of the various forms of malpractices were clearly acknowledged in a major policy statement issued by the Central Bank of Nigeria on March 5, 1992. Among others, it was stated that "There is clear evidence that most authorised dealers or their agents have engaged in under-the-counter deals which undermine the credibility of the FEM. Many operators are even believed to be diverting foreign exchange from the official to the parallel market to make substantial profits. Also, many users of foreign exchange are known to source their foreign exchange needs from the official market while diverting their own foreign exchange earnings to the parallel market....". These are the factors which have prevented the benefits derivable from exchange rate from accruing to the economy at large.

In addressing the situation, and to ensure that the full objectives of FEM are received, some corrective measures were introduced with effect from the day the statement was made. The measures involved total liberalisation of the FEM in which the practice of foreign exchange allocation to the banks on predetermined quotas was discontinued. The market became purely an inter-bank market in which the Central Bank is one of the participants, free to buy and sell foreign exchange at the rate freely determined by all authorised dealers. The Central Bank now influences the exchange rates by "open market operations".

Since the introduction of the new policy, the naira has substantially appreciated. Immediately after the policy was adopted the CBN announced the exchange rate of N18.0 = $1.0, showing a depreciation of 41.3 per cent from the ruling rate of N10.5564 = $1.0 before the announcement. The currency further depreciated to N18.75 = US$1.0 the following week before improving slightly to N18.60 = US$1.0 on 24th March, 1992.

It is significant to note that during the first month following the announcement, the number of the participating banks, the total amount demanded and the amount actually taken up consistently decreased. For the weeks beginning 4/3/92, 17/3/92, and 24/3/92, 120, 113 and 96 banks participated respectively, demanding US$407.0 million, US$129.1 million and US$82.2 million respectively and purchasing actual amounts of US$384.9 million, US$86.4 million and US$59.6 million respectively. The reasons for this declining trend were attributed to factors including the effect of liquidity mop-up which resulted from the banks surrender of the naira equivalent of the dollar sales by the CBN, which for the three weeks totalled N9,658.5 million. Also, sluggish demand for foreign exchange by users, some of whom found it too expensive. If the trend continues the new measures will, probably give the needed discipline if they are not disturbed by any adverse developments, such as expansionary fiscal and monetary operations. Should the measures succeed, the naira will experience a relief, resulting in the appreciation of the currency.

PART IV SUMMARY AND CONCLUSION

This paper has been concerned with describing the administration of the naira exchange rate primarily under the on-going Structural Adjustment Programme (SAP). In a brief review of the pre-SAP exchange rate determination when exchange control was the central commercial policy, the ineffectiveness of the system was seen in the fact that the currency became overvalued, and together with the restrictive trade and payment measures of the period was incapable to bail the country out of serious economic crisis. Aggravated by the substantial loss in the demand for her main export, crude oil, the country's foreign exchange earnings plummeted. Initially, the high level of import demand could not be immediately moderated, resulting in the accumulation of trade credit. The non-oil sector having become import dependent with very little to export, there existed a situation of fundamental disequilibrium.

Adoption of SAP in 1986 became necessary after several efforts to contain the situation through more stringent trade and payment restrictions became ineffective. One of the central elements of SAP was a market-determined exchange rate aimed at removing the naira overvaluation and the achievement of efficient resource allocation. Although the market-determined exchange rate had succeeded in removing the problems of over-valuation, exchange rate instability has persisted, resulting in non-realisation of the benefits derivable from exchange rate adjustment.

The reasons for this unsatisfactory situation are attributed mainly to over-liquidity in the system resulting from expansionary fiscal and monetary developments, and the indiscipline of some speculative market operators. This led the CBN to adopt far-reaching policy measures on 5th March, 1992 aimed at sanitising the system. Although, it is too soon to speak confidently on the success of the new measures, available indicators point to the fact that the policy is along the right discretion.

TABLE 1
NIGERIA: EXCHANGE RATE OF THE NAIRA VIS-A-VIS UNITED STATED DOLLARS 1960–DATE (NAIRA/DOLLAR)

YEAR/ MONTH	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.	ANNUAL AVERAGE
1960	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1961	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1962	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1963	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1964	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1965	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1966	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1967	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1968	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1969	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1970	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143
1971	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.7143	0.6579	0.6579	0.6579	0.6579	0.6579	0.6955
1972	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6570	0.6579
1973	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6579	0.6570	0.6579
1974	0.6579	0.6579	0.6579	0.6579	0.6162	0.6162	0.6162	0.6162	0.6135	0.6162	0.6162	0.6162	0.6299
1975	0.6158	0.6146	0.6138	0.6124	0.6124	0.6077	0.6077	0.6113	0.6178	0.6253	0.6257	0.6257	0.6159
1976	0.6244	0.6236	0.6246	0.6250	0.6250	0.6262	0.6265	0.6265	0.6265	0.6280	0.6310	0.6310	0.6265

YEAR/ MONTH	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.	ANNUAL AVERAGE
1977	0.6310	0.6310	0.6370	0.6500	0.6513	0.6513	0.6513	0.6513	0.6513	0.6513	0.6513	0.6513	0.6467
1978	0.6374	0.6475	0.6203	0.6119	0.6190	0.6116	0.6058	0.5892	0.5892	0.5699	0.5847	0.5849	0.6060
1979	0.6475	0.5482	0.6396	0.6212	0.6159	0.6055	0.5900	0.5802	0.5749	0.5753	0.5803	0.5705	0.5958
1980	0.5563	0.5482	0.5591	0.5611	0.5611	0.5443	0.5431	0.5443	0.5338	0.5314	0.5317	0.5419	0.5464
1981	0.5323	0.5469	0.5722	0.5994	0.5994	0.5905	0.5992	0.6680	0.6671	0.6609	0.6488	0.6356	0.6100
1982	0.6437	0.6559	0.6643	0.6696	0.6696	0.6756	0.6794	0.6810	0.6843	0.6898	0.6892	0.6720	0.6729
1983	0.6736	0.6917	0.6999	0.7048	0.7048	0.7272	0.7447	0.7486	0.7486	0.7486	0.7486	0.7486	0.7241
1984	0.7486	0.7486	0.7486	0.7486	0.7486	0.7543	0.7676	0.7676	0.7682	0.7748	0.7957	0.8061	0.7648
1985	0.8203	0.8477	0.8746	0.8825	0.8917	0.8951	0.8951	0.8959	0.9157	0.9225	0.9234	0.9595	0.8938
1986	0.9996	0.9996	1.0016	1.0185	1.0341	1.1249	1.2694	1.3294	4.6406	4.1203	3.5311	3.1828	2.0210
1987	3.6471	3.7014	3.9213	3.9054	4.1617	4.0506	3.8081	4.0809	4.2073	4.2761	4.2890	4.1664	4.0179
1988	4.1748	4.2611	4.3169	4.2023	4.1103	4.1913	4.6087	4.5830	4.7167	4.7748	5.1479	5.3530	4.5367
1989	7.0389	7.3828	7.58761	7.5808	7.5051	7.3477	7.1388	7.2593	7.3401	7.3934	7.5037	7.6221	7.3917
1990	7.8621	7.9009	7.9388	7.9400	7.9400	7.9424	7.9523	7.9623	7.9743	8.0089	8.3246	8.7071	8.0378
1991	9.2121	9.6108	9.4521	8.8691	9.3700	10.1722	11.0474	11.3280	10.2416	9.8805	9.8651	9.8650	9.9095
1992	9.5508	10.3091											

TABLE 2
NAIRA/DOLLAR EXCHANGE RATES IN THE BUREAUX DE CHANGE AND PARALLEL MARKET

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.	ANNUAL AVERAGE
1989:													
Bureauxe de Change rates								10.20	10.37	10.47	10.15	9.48	10.13
Parallel Rates								10.13	10.35	10.46	10.12	9.46	10.53
1990:													
Bureaux de Change rates	9.51	9.49	9.26	9.27	9.30	9.47	9.47	9.67	9.78	9.91	10.15	10.09	9.65
Parallel Rates	9.50	9.41	9.20	9.20	9.26	9.44	9.79	9.62	9.72	9.85	10.13	10.16	9.61
1991:													
Bureaux de Change rates	10.84	11.86	12.05	12.40	12.64	13.28	14.20	14.42	14.27	15.06	15.53	15.68	13.52
Parallel Rates	10.88	11.87	12.04	12.42	12.64	13.24	14.14	14.38	13.99	14.77	15.48	15.58	13.45
1992:													
Bureaux de Change rates	16.72	18.45	20.00										
Parallel Rates	16.71	18.45	19.92										

Note: Bureaux de change started in August 1989

TABLE 3
EXPORT OF MAJOR COMMODITIES BY ECONOMIC SECTORS

	QUANTITY (THOUSAND TONNES UNLESS OTHERWISE STATED)					VALUE (N MILLION)					PERCENTAGE OF TOTAL EXPORT VALUE				
COMMODITY	1986	1987	1988	1989[1]	1990[2]	1986	1987	1988	1989[1]	1990[2]	1986	1987	1988	1989[1]	1990[2]
	(1)	(2)	(3)	(4)	(5)										
Major Agricultural	242.8	332.5	497.4	360.9	584.0	407.4	1588.5	1780.4	1726.8	2857.0	4.6	5.2	5.7	3.0	2.6
Mineral products	445.7	389.5	429.2	507.3	548.2	8368.4	28,206.6	28,435.4	55,016.8	106,626.5	93.8	902.9	91.2	94.9	97.0
Manufactures and Semi-manufactures of Agric. Products	23.6	13.4	8.6	22.1	41.5	54.2	61.5	82.0	115.9	219.8	0.6	0.2	0.3	0.2	0.2
Textiles	-	-	-	-	-	-	-	n.a	109.9	-	-	n	n	0.1	
Tin Metal	0.2	1.6	0.4	0.2	-	1.3	30.2	8.7	5.0	-	n	0.1	n	n	0.1
Precious Metal	-	-	1.9	0.1	0	0-	-	13.1	1.1	-	-	-	n	n	-
Other Exports	-	-	-	-	-	89.2	471.8	873.1	1105.69	182.8	1.0	1.6	2.8	1.9	0.1
Total Domestic Export	-	-	-	-	-	8920.5	30,360.6	31,192.8	57.971.2	109,886.1	100	100	100.0	100.0	100
Re-Export	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Total Exports	-	-	-	-	-	8920.5	30,360.6	31,192.8	57.971.2	109,8986.1	100.0	100.0	100.0	100.0	100.0

NOTE
1. Revised
2. Estimated
3. Quantity in million
n = Negligible
n.a. = Not available

TABLE 4

IMPORTANT ECONOMIC VARIABLES

PERIOD	NON-OIL EXPORT EARNINGS	FEDERAL GOVERNMENT DEFICIT FINANCING	INFLATION RATES
1986	$388.0	N8,254.3 Million	5.4
1987	$537.1	N5,889.0 Million	10.2
1988	$611.9	N12,160.9 Million	38.3
1989	$400.0	N15,266.1 Million	40.9
1990	$405.8	N23,357.0 Million	7.5

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