Bullion

Volume 30 | Number 4 Article 1

9-2006

Overview of currency management in Nigeria.

K. S. Adeyemi
Union Bank of Nigeria PLC, Nigeria.

OVERVIEW OF CURRENCY MANAGEMENT IN NIGERIA

By:

DR. K. S. ADEYEMI

Executive Director (IT & Services), Union Bank of Nigeria PLC

DR. K. S. ADEYEMI

1.0 INTRODUCTION

Before the introduction of money, trade was essentially by barter. A major drawback of this system was that it was cumbersome and time-consuming as it required double coincidence of wants before exchange could take place. Consequently, it discouraged specialization and division of labour, with all its associated benefits.

With the subsequent introduction of money, however, exchange no longer requires that both the seller and buyer have goods that the other party is interested in. In other words, it is no longer necessary for someone who wants to sell an item to look for a buyer who, at the same time, would have other goods for sale that the initial seller is interested in. For money to effectively serve as a medium of exchange, it must be generally acceptable, portable, durable, divisible into small units and relatively stable in value, among other attributes. It is from this perspective that the advantages of paper money over earlier forms like precious metal (gold, diamond, silver, copper, etc) and cowrie can be appreciated. Even though paper money has no intrinsic value like these earlier forms of money, it still has a high extrinsic or face value based on the credibility of the issuing authority.

The Central Bank of a country is the institution charged with the responsibility for issuing legal tender currency. The Central Bank of Nigeria (CBN) is, therefore, vested with this responsibility. The objective of a central bank in discharging this core function is "to give the public, adequate quantity of supplies of currency notes and coins and in good quantity" (Reserve Bank of India, 2006). Given the centrality of coins and notes in a nation's payments system, it is important that the issues involved in managing a nation's currency are well understood. Consequently, in this paper we will seek to highlight the issues in currency management, identify the challenges of currency management in Nigeria, and situate the currency management reforms of the CBN in proper context.

In order to achieve these objectives, the paper has been structured into six sections. Following this introduction, we highlight the key dimensions of the currency management function in section 2. Section 3 reviews the major currency episodes in Nigeria while section 4 examines the shortcomings of the existing currency arrangements. We discuss Nigeria's reform effort in currency management in Section 5 and conclude the paper in section 6.

2.0 CORE COMPONENTS OF THE CURRENCY MANAGEMENT FUNCTION

The operations of the Central Bank of Kenya (CBK) provide useful insight into the core functions of currency management. The CBK (1986) regards the supply of bank notes and coins to the economy as a principal responsibility of the central bank. The satisfactory discharge of this responsibility requires the central bank to keep adequate stocks of notes and coins, and to establish a smooth distribution system for the currency. Currency management is the issuance, management and withdrawal / destruction of currency consistent with the overall goal of price stability as well as high and stable economic growth. The components of currency management thus encompass the following:

- Estimation of demand for various denominations of currency. This involves making forecast of requirement for notes and coins and ordering supplies in good time before the existing stock is exhausted.

- Actual printing of the currency is undertaken using skills that make it very difficult for others to reproduce the currency accurately. It requires painstaking choice of materials, elaborate design features and watertight security to avoid counterfeiting.

- Movement of currency from the central bank to the public and vice-versa are mainly through the commercial banks. The public obtains currency from the commercial banks when government at all levels and other formal sector employers pay their workers; and governments and corporate organizations pay their contractors and suppliers with cheques drawn on the central bank and the commercial banks as appropriate. The commercial banks get supplies of currency from the CBN by either drawing down their deposits or by selling some of their monetary assets, like treasury bills and treasury certificates, to the central bank. Currency flows back to the commercial banks in the following ways:

When traders use the proceeds of the sale of their stocks to the public to repay loans taken from banks.

When traders deposit proceeds of their sales in their commercial bank accounts.

When farmers, artisans and workers deposit their savings in their commercial bank accounts.

The commercial banks return to the central bank, any excess amount of currency, which they do not need, and build up their deposits with the apex bank in the process.

- Sorting of currency: In the process of using currency for transactions, they wear out and get dirty, defaced and mutilated. The commercial banks could sort out the unfit currency and return to the central bank for replacements or they could leave the sorting of currency to the central bank. The central bank maintains note sorters to sort out the unfit currency.

- Note Replacement: The result of note sorting is that the clean notes are reissued while the unserviceable ones are destroyed. The destroyed notes are replaced by printing new ones so that a fairly stable amount of currency in circulation is maintained.

- The storage of currency is undertaken at different levels, by the central bank, commercial banks, and to some extent, the corporate organizations pending the time of depositing the cash with the commercial banks. The central bank is supposed to keep a buffer stock of currency to meet exceptional demand for currency at peak periods while the commercial banks must keep adequate stock of currency on daily basis to meet depositor's withdrawal needs. All these involve adequate investments in vault space.

3.0 CURRENCY ISSUE EPISODES IN NIGERIA

The first major issue of currency in Nigeria was undertaken following the Colonial Ordinance of 1880, which introduced the shilling as the sole legal tender currency in British West Africa, (Oshilim, 2000). The coins were issued and managed by the Bank of England. The units of the coins introduced were 1/10 penny, ½ penny, and 1 penny. The one-shilling coin was the highest denomination then. A private bank, the Bank for British West Africa (BBWA), the forerunner of the present First Bank of Nigeria Plc. was used to distribute the currency in West Africa until 1912 when the West African Currency Board (WACB) was established. The WACB took over responsibility for note issue in Nigeria, Ghana, Sierra Leone and The Gambia. It issued the 3 pence, 6 pence, 1 shilling, and 2-shilling coins in 1913. The 2-shilling coins remained the highest denomination of currency until 1919 when the 10 shilling and £1 note were introduced. The £1 note was the highest denomination currency until 1959 when the CBN was established.

We can identify the following episodes of currency issue in Nigeria since the inception of the CBN in 1959.

- The CBN issued Nigerian notes in the denominations of 5 shillings, 10 shillings and £1 in 1959.

- The assumption of the Republican status by Nigeria required the re-issue of the country's currency notes in 1963.

- During the Nigerian Civil War (1967-1970), there was a currency re-issue targeted at demonetizing the Nigerian currency in the then Biafra.

- In 1973, Nigeria decimalized its currency and replaced the pounds, shillings and pence with Naira and Kobo. The coin denominations were: ½k, 1k, 5k, 10k and 25k while the denominations of notes were: 50k, ₦1, ₦5 and ₦10.

- The ₦20 note was introduced in 1977 in response to the rapid economic growth ushered in by the oil boom (Nnadi, 2000).

- In 1984, the colours of existing currencies were changed to demonetize money allegedly stolen by politicians and kept outside the banking system.

- The ₦50 note was introduced in 1991 following the increased pressure on the payment system resulting from the increased national spending made possible by the Gulf War oil revenue windfall. In the same year, the CBN demonetized the 1/2kobo and 5kobo denominations of the coins and converted the previous 50k and ₦1 notes into coins.

- The ₦100 note was issued in 1999.

- The ₦200 note was introduced in November 2000.

- The ₦500 note was introduced in April 2001.

- The ₦1000 note was issued in October 2005.

4.0 PROBLEMS OF CURRENCY MANAGEMENT

Teriba (1998) and Soludo (2005) identified the drawbacks of currency management in Nigeria as follows:

- Widespread aversion to the use of coins among the populace. A major complaint of users is that the coins are inconvenient to carry about because of their heavy weight and large size. A further factor contributing to the aversion to the use of coins is their rather highly diminished value (Soludo 2005). When the ₦1 note was issued in 1973, it was worth US$1.50. However, by the time it was coined in 1991, it had a nominal value of ten cents, and by 2006 it was worth only 0.78cents. As the highest denomination of coins is not worth much in terms of quoted prices of goods/services, the lower denominations seem to be even more worthless.

- There is a general problem of rounding up retail prices to the nearest unit at which notes can be used. Buyers and sellers experience this problem, which has wider repercussions for production and consumption decisions. A recommended price for a good at ₦17, for instance, will be inoperative, as this would be rounded up to ₦20. According to Teriba (1998), this makes it difficult to achieve the level of production and sales consistent with the recommended price because, the effective retail price is too high. Yet another implication of this pricing regime is that producers cannot implement marginal reductions in retail prices to boost sales as only retail prices based on multiples of five naira notes can be fully enforced.

- The use of paper currency notes for high velocity, small value transactions results in the defacement and mutilation of such notes. This adds to the cost of currency management as notes, especially lower denomination notes, generally have shorter life span ranging from two to three years compared to coins, which have a life span of 15-30 years (Teriba, 1998). Using notes for high velocity small value transactions implies they have to be replaced earlier than their normal life span. Consequently, the currency destruction rate in Nigeria is higher than normal when compared with other countries across the globe. This makes currency management more expensive in Nigeria.

- Large volume of currency in circulation was a problem also acknowledged by Soludo (2005). The total pieces of coins in circulation was 2 billion in 1985 but declined only to 1.2 billion pieces in 1997 (Teriba, 1998) and has remained at this level since then, even though they are not commonly used in transactions because of their seeming worthlessness. The volume of Naira notes in circulation was 5.4 billion pieces by December 1997. As shown in Table 2, the volume of Naira notes was still in excess of 4 billion pieces as at December 2005, down from 8.3 billion pieces in 2000. The large volume of currency in circulation has been a consequence of the pre-dominance of lower denomination notes in the total currency mix. In 1999, the ₦5, ₦10 and ₦20 denominations accounted for 61% of the total volume of currency in circulation and only 41% of the value of currency in circulation. In 2005, this category of currency denomination constituted 43% of the volume and only 3% of the value of currency in circulation. A preponderance of notes of lower denomination increases the costs for distribution, storage, processing and the printing of currency.

Table 1: Currency Structure in Nigeria (Value of Denominations, N'm)

Coin/Note	1999	2000	2001	2002	2003	2004	2005
Coin							
₦1	959	1,051.9	436.6	404.6	443.4	445	447
50k	487	524.8	216.9	217.7	218.2	219	219
25k	101	106.5	43.4	43.4	43.4	43	43.1
10k	29	31.5	12.6	12.6	12.6	12.6	12.6
1k	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Note							
₦5	1,568	2,386.2	2,198	2,233.7	2,665.4	2,719	2,569
10	4,033	5,099.4	4,155	4,083.8	6,583	3,402	5,861
20	79,742	81,417	52,648.	39,849.8	26,037	20,186	12,440
50	117,480	117,079	76,548	47,394.3	23,022	8,722	15,738
100	4,169	74,829	72,226	69,353.6	63,618	55,591	43,984
200	-	27,972	84,085	113,961.9	127,379	153,265	155,314
500	-	-	113,042	186,077.6	252,500	301,128	371,000
1000	-	-	-	-	-	-	34,607
Total	208,563	308,782	404,901	463,398.	502,522	545,733	642,234

Source: CBN Annual Report and Statement of Accounts (several years)

Table 2: Currency Structure in Nigeria (volume of denominations, millions)

Coin/note	1999	2000	2001	2002	2003	2004	2005
Coin							
N1	954	1,052	437	441	443	445	447
50k	973	1,050	434	435	436	437	438
25k	404	426.0	174	173	173	173	173
10k	294	315.0	126	126	126	128	129
1k	40	40.0	41	40	40	41	41
Sub-Total	2,665	2,883	1,211	1,215	1,219	1,219	1,224
Note							
N5	314	477	440	1,993	533	544	514
10	403	510	416	948	658	340	586
20	3,987	4,071	2,632	694	1,302	1,009	622.0
50	2,350	2342	1,531	569	460	174	315
100	41.7	748	722	694	636	556	440
200	-	140	420	569	637	766	777
500	-	-	226	372	505	602	742
1000	-	-	-	-	-	-	34.6
Sub-Total	7,095	8,288	6,387	5,837	4,732	3,992	4,030
Total	9,760	11,170	7,598	7051	5,951	5,215	5,254

Source: CBN Annual Report and Statement of Accounts (several years)

The volume of currency in circulation in Nigeria is high also partly because; transactions in the country are largely cash-based. This, in turn, is because of the relatively poor banking habit across the country. The poor banking habit is not unconnected with the literacy level in the country and the limited outreach of the banking system which, in spite of the rural banking programme of the 1970s/80s, still remains urban-sector biased. The level of distrust among the citizenry and the failure to enforce existing laws relating to the issuance of dud cheques are additional factors. On account of these, the use of cheques and other payment instruments has remained relatively low due to the lack of confidence in such instruments.

- Another problem is the near-absence of private sector participation in currency management (Soludo, 2005). The printing and minting of currency is done by the CBN through the Nigerian Security Printing and Minting Company (NSPMC) Plc with shortfalls met through importation. The NSPMC Plc was established in the 1960s by the Federal Government in partnership with major security printing companies abroad, with the CBN holding minority equity interest. However, the company eventually went the way of most public enterprises in Nigeria and could, therefore, not meet the currency printing needs of the CBN. The result is that Nigeria is one of the few countries in the world with a mint and yet imports banknotes. This is because the company has not been able to produce up to one billion notes in any given year in the last ten years (Soludo, 2006).

- Currency movement challenges. The distribution, storage and processing of currency is undertaken substantially by the CBN through its branches/currency centres in the states. In this regard, it is pertinent to note that most of the states created in the last fifteen years are yet to have CBN branches. As a result, bullion vehicles have to traverse long distances to carry or deposit currency in CBN vaults and, in the process, face enormous risks of armed robbery attacks in addition to the colossal direct costs of transportation.

- Low level of automation of currency management in Nigeria (Soludo, 2005) has also constrained efficiency in currency management. The large number of low denomination notes, counted manually without the aid of high technology sorting equipment in Nigeria has been fingered as the cause of long queues in the banks (Oshilim, 2000).

5.0 REFORM EFFORTS IN CURRENCY MANAGEMENT

The CBN introduced the D-Metric System of currency management in 1991. According to the CBN (1991, p.129), the system assumes equal denominational structural range of five for both coins and notes. Accordingly, the reform involved the phasing out of ½k and 5k coins, the redesign of the 1k, 10k and 25k coin denominations, the coinage of 50k and ₦1 notes, and the introduction of ₦50 notes. While there were five denominations of coins, only four denominations of notes, namely, ₦5, ₦10, ₦20 and ₦50, existed until 1999.

As from July 1, 1997, the CBN required commercial banks to sort their currency before lodgements with it. A stipulated penalty was payable on unsorted lodgements after this date. In order to comply with this directive, some banks installed desktop currency sorting systems while a consortium of banks floated a currency sorting company (Teriba, 1998). The currency sorting company, however, collapsed due to low patronage.

The issuing of higher denomination notes in 1991, 2000, 2001 and 2005 is also consistent with the currency reform effort of the CBN. According to Soludo (2005), the focus of the current currency management reform is a comprehensive review of the entire currency series to address the following issues: Denominational structure of the Naira; Limited use of coins for transactions; Dirty notes in circulation; and High cost of currency management.

The CBN plans to outsource currency distribution and processing to enable it focus on the directional issues of currency management such as: Currency Issuance; Research and Development; Currency Control and Disposal and Supply Chain Facilitation.

The CBN has acquired majority shareholding in the NSPMC Plc and has taken over the management of the company. A functional and competitive NSPMC Plc is expected to facilitate the attainment of the CBN's goal of stopping importation of finished bank notes by December 31, 2006.

According to Soludo (2006), the currency reform efforts of the CBN have included the following activities:

- Re-designing of the lower bank note denominations (₦5, ₦10, ₦20 and ₦50).
- Planned introduction of new coin series (existing 50k and ₦1) and a new ₦2 coin.
- Planned re-issue of ₦20 in polymer substrate.
- Reduction in the effective cost of notes by 41-58% and that of coins by about 60%.
- Increased CBN shareholding in the NSPMC Plc from 2.35% to 77%, and the subsequent comprehensive plant restructuring and heavy investment in the company to meet the target of self-reliance.
- Turning NSPMC Plc from its loss-making position in 2004 to a profit-making outfit in 2005.

- Over 30% increase in the output of NSPMC Plc such that it produced 1.27billion notes in 2005, the first time it was exceeding the 1billion mark in the number of notes produced in over ten years.

- As we had earlier stated, the existing coins (including the ₦1, which is the highest denomination), are hardly used in settlement of transactions. One therefore wonders why the CBN is still planning to re-issue any of these coins and proposing to issue ₦2 coins? Given existing retail prices, it may be more meaningful for the ₦5 note to be coined although this suggestion is not without its own consequences.

- The most widely held of the notes in Nigeria by 2005 were the ₦100, ₦200 and ₦500 and these accounted for 48.6% of volume and 88.8% of value of currency in circulation (see Tables 1 and 2). It is pertinent to observe that even these denominations are not worth much in dollar terms, with the highest denomination of the Naira, the ₦1,000 note, worth only approximately US$8.00. In the face this, coupled with societal preference for notes as a medium of payment, should we not look forward to having notes with a minimum exchange value of US$10? However, such a suggestion tends to support the dollarisation of the domestic economy, a situation which has its own implications.

6.0 <u>CONCLUSION</u>

We have x-rayed the entire gamut of the currency management functions and have highlighted the peculiar challenges of currency management in Nigeria. In the process, some of the recommendations towards effective and efficient currency management in Nigeria have been alluded to. However, we still need to itemise them so as to underscore their importance and urgency.

- First, as inflation has substantially eroded the value of the existing range of coins, it is advisable to demonetise some of them. To be meaningful, the present ₦5 note should be coined.

- To facilitate currency distribution, the CBN should establish branches in those States of the Federation where it is not yet represented. This would go a long way in minimizing the cost and risks involved in currency movements. Ultimately, this function should be privatized.

- Furthermore, as is the practice in the United Kingdom, there is need to explore the possibility of using a private company to distribute currency through the Automated Teller Machines (ATMs).

- The CBN should also expedite action on withdrawing defaced and dirty Naira notes from circulation.

- It should also sustain the tempo of its current awareness programme on the handling of Naira notes.

References

CBK (1986), Central Bank of Keyna: Its Evolution, Responsibilities and Organisation, Chapter 2

CBN (1991), Annual report and Statement of Accounts.

CBSL (2005), Press Release of the Central Bank of Sri Lanka on the Printing of the High Denomination.

Nnadi, B C (2000), "The Need For Higher Denomination Currency in Nigeria", Bullion, Vol. 24, No. 4, October/December.

Oshilim, F E (2000), "The Need For Higher Denomination Currency in Nigeria", Bullion, Vol. 24, No. 4, October/December.

Pedro, I. (2000), "The Need For Higher Denomination Currency in Nigeria", Bullion, Vol. 24, No. 4, October/December.

Teriba, A O (1998), "Business and Policy Issues in Re-denominating the Naira", LBS Management Review, Vol.3, No. 2, July-December.

Soludo, C C (2005), "Keynote Address at the National Seminar on Cash Handling, Automation and Management, Lagos, 9-10 August.

Soludo, C C (2006), Update on CBN and Reforms.

Wikipedia (2006), see http://en.wikipedia.org/wiki/currency.