Economic and Financial Review

Volume 27 | Number 1 Article 5

3-1-1989

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Recommended Citation
Ogbe, N.E. (1989). The internationalisation/convertibility of the Naira. Economic and Financial Review, 27(1), 30-37.

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THE INTERNATIONALISATION/CONVERTIBILITY OF THE NAIRA*

BY

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Abstract

The paper examined issues relating to the internationalisation of the Naira, a term which is synonymous with convertibility. It stated that a currency is deemed convertible where there are no restrictions imposed on payments and transfers for current international transactions. It also highlighted the importance of convertibility to an economy. The pre-conditions for convertibility were identified to include the existence of a realistic exchange rate under a free international trade and payments regime, the availability of adequate foreign reserves, maintenance of internal balance, and the operation of similar exchange rate regimes by the country's major trading partners. The evolution of currency convertibility on a global basis as well as the efforts to establish convertible currencies in the West African sub-region were reviewed. The experiences under the gold standard, the gold exchange standard, the Bretton Woods Arrangement and the current floating rates regime showed clearly the difficulty of achieving and sustaining full currency convertibility. This difficulty was also manifest in the experience of the West African sub-region in the joint effort to solve the problem of currency convertibility among ECOWAS countries through the establishment of a common new currency within an ECOWAS monetary zone. The paper then went on to propose what it considered to be a more viable alternative whereby Nigeria has to make the naira convertible through her own independent efforts. The current economic setting in which liberalized exchange and trade policies are being pursued through the Structural Adjustment Programme was considered to have succeeded in putting the Naira on track towards convertibility. The paper pointed out, however, that several of the necessary conditions for the establishment of a convertible currency are yet to be fulfilled in the Nigerian case. In conclusion, it expressed the hope that within the perspective planning horizon of 15-20 years, the naira has a good chance of attaining convertibility particularly if the current policies are sustained.

Introduction

An important objective of planning for any economy is the achievement of a viable external sector in an effort to maintain equilibrium in the domestic sector. This underscores the mutually interdependent nature of both sectors in economic growth and development. Developments in the sectors are usually manifested in a nation's balance of payments position. Besides making projections on macro-economic variables in the domestic sector such as savings, investments, etc., economic planners often trace the time paths of such balance of payments aggregate as imports, exports, capital flows, debt service and reserve movements within a plan framework. The volume of these latter variables depends on a number of causative factors, not least being the quality of the means of payment for international transactions.

Thus, *ceteris paribus*, the volume of trade tends to be boosted for a country whose currency is freely and directly exchangeable with those of other countries. The same tendency for substantial increases exists for capital flows across countries, because of the facilitating effects of currency convertibility. It is thus little wonder that economic planners in dynamic environments of developing countries such as Nigeria, where currencies are localised and largely inconvertible, do often pre-occupy themselves with perspective policy simulations on variables in the external sector, under scenarios based on assumed degrees of convertibility of the local currency. Such variables include trade and other current account aggregates that are relevant for planning in the medium to long-term.

The purpose of this paper is to discuss issues pertaining to the internationalisation of the naira, a term which is synonymous with convertibility of the naira, review the evolution of currency convertibility, and the implications of this for the economies of such countries with convertible currencies. The paper delineates efforts made so far in the West African sub-region to achieve currency convertibility in the ECOWAS countries. It subsequently articulates the possibilities and proffers strategies for internationalising the naira completely independent of the ECOWAS common currency approach.

The discussion is organised into six parts, for ease of presentation. Part I dwells on issues of definition of concepts and the pre-conditions for currency convertibility. Part II provides a review of the evolution of currency convertibility including the dynamics of their convertibility status, while Part III focuses on the current efforts of ECOWAS aimed at establishing a convertible common currency for the sub-region, highlighting the attendant problems and unresolved issues. Part IV outlines trends in Nigeria's exchange control payments restrictions and naira convertibility. Part V contains

* Being the text of a lecture presented at the National Workshop on the Role of the Financial Sector in Perspective Planning for Nigeria, at the National Assembly Complex, Lagos.

a consideration of the possibility and desirability of a convertible Nigerian currency, independent of the ECOWAS monetary zone experiment. Part VI summarises and concludes the paper.

PART I: THE CONCEPTS OF CONVERTIBILITY

The concept of internationalisation of a currency can, for all intents and purposes, be deemed to be synonymous with the more familiar concept of currency convertibility. Full currency convertibility has been defined as the unrestricted exchange of the currency of a country into all other currencies without any limitations being imposed on the usability of the currency. Thus full currency convertibility implies complete absence of foreign payments restrictions, whether on current or capital international transactions.

In actual practice no such absolute or full convertibility now exists. This is because even in the most economically advanced countries whose currencies are said to be convertible, restrictions are still placed on capital transfers or transactions. Thus, a currency is deemed convertible where there are no restrictions imposed on payments and transfers for current international transactions. The definition implies that restrictions on capital transfers are permitted and consistent with convertibility. This narrower concept is the one adopted by the International Monetary Fund (IMF).

However, when UNCTAD applied the concept of limited convertibility to ECOWAS currencies, the concept, though rendered more operational, loses that rigour, appearing less restrictive than it connotes under the IMF definition above. The UNCTAD concept of limited convertibility of ECOWAS currencies may be defined as "a set of co-ordinated national exchange arrangements undertaken by those ECOWAS countries to provide for a programme of faster liberalisation for inter-regional payments than in respect of payments to the rest of the world" For an initial period preferential liberalisation of inter-regional payments does not necessarily need to cover all intra-ECOWAS transactions but may be restricted to intra-community trade which is eligible for preferential treatment on the basis of the approved ECOWAS trade liberalisation programme.

PRE-CONDITIONS FOR CONVERTIBILITY

There are several conditions whose existence underlie the successful establishment of a convertible currency. These relate to the existence of a realistic exchange rate under a free international trade and payments regime, the availability of adequate foreign exchange reserves, maintenance of internal balance, and the operation of similar exchange rate regime by the country's major trading partners.

(a) Realistic Exchange Rate

Under a free international trade and payments regime, which is what currency convertibility implies, the exchange rate operating in the country should reflect the strength of inflows and outflows of foreign exchange. The rate of exchange would be such that makes the balance of payments tend towards equilibrium. This will be the case when the earnings from exports plus net capital inflow are at least equivalent to what is necessary to cover the import bills. At the realistic rate of exchange under which a currency is convertible, the cost and price level in the country should not be seriously out of line with the cost and price level of its trading partners, at least for commodities and services that enter into international trade.

(b) Adequate Reserves

It is important that the country concerned should have sufficient reserves covering several months imports to enable it to withstand the strain of possible deficits for a period. How much is adequate for this purpose would be contingent on such factors as the country's capacity to raise foreign loans, the fluctuations in the balance of payments partly discernible from past trends, structural changes affecting cost-price relations arising from differences in export and import and the destabilising effects of speculation. The need for the country to have adequate reserves to meet obligations of convertibility can therefore not be overemphasized. Moreover, it is very necessary not only that the country possesses relatively large and sustained capacity to earn foreign exchange but also a diversified export base.

(c) Maintenance of Internal Balance

A major precondition to convertibility is the correction of balance of payments disequilibrium and the pursuit of policies to sustain the equilibrium. The more convertible a currency is the less restrictive are impediments to external economic transactions. Full convertibility assumes that trade and payments restrictions are non-existent.

BENEFITS OF CURRENCY CONVERTIBILITY

(a) Ability to Expand Trade in the Long Run

The more convertible a currency is the more the scope to expand trading activities beyond traditional frontiers to other areas hitherto unexploited. The increased trading opportunities will result in increased production, diversification of the export base and an upward movement in intra-regional trade.

(b) Increased Investment Inflow

As a result of trade liberalisation and a more efficient allocation of resources, investors will be encouraged to invest in the economy. The perception of the area as a potential market and the fact that returns on investment could be repatriated without being subject to restrictions, make the economy attractive to foreign investors. Increased direct investment would also help to increase the domestic production of goods and services needed in the economy.

(c) A More Rational and Efficient Allocation of Resources

Since foreign investors are more likely to invest in areas with very high returns, investible funds would be more rationally and efficiently allocated. Also, the fact that the exchange rate must have been set at a near optimum level to achieve convertibility means that market forces would be crucial in determining investment decisions.

(d) **Parallel Market**

In countries with convertible currencies, unofficial or parallel markets for foreign currencies are not significant nor widespread. Market mechanism allocates available foreign exchange and there are hardly unsatisfied demands from official sources so strong as to warrant a recourse to parallel markets. Smuggling of goods tends to be minimised under convertible currency regimes.

Disadvantages of Currency Convertibility

Although convertibility of currency confers tremendous advantages, as enumerated in the preceding paragraphs, it also imposes costs or constraints on the country with convertible currency. The constraints probably explain why only few countries in the world maintain convertible currencies. Probably the most significant of the disadvantages or constraints is the reduction in policy options available to the government of the country to deal with serious balance of payments development because it can no longer impose payments and other direct restrictions on current transactions. Another disadvantage is the heavy responsibility which convertibility forces on government to ensure that it maintains at all times adequate foreign exchange reserves so as to be able to meet demand. This type of obligation is usually not possible for countries to meet, especially those in the Third World that do not have a diversified export base.

Another constraint especially for a developing country that seeks to make its currency convertible is the inflationary pressure that may follow the removal of restriction and depreciation of the currency at the initial stages of convertibility.

PART II: EVOLUTION OF CURRENCY CONVERTIBILITY

From the very early times goverments have reoognised the importance of currency convertibility and free trade regimes. Hence, efforts were made to establish international trade systems that were free from government restrictions especially from the later part of the 19th Century. This was the aim behind the evolution and or the establishment of systems such as the gold standard, gold exchange standard, Bretton Wood system, etc.

The Gold Standard

A country is on the gold standard when its basic monetary unit (dollar, pound sterling, franc, etc.) is defined in terms of a specified weight of gold and when its monetary authorities stand ready at all times to buy and sell gold in unlimited quantities at the rate fixed by the legal gold content of the monetary unit. Thus, under a true international gold standard the monetary unit is expected to possess the attribute of absolute or full convertibility.

The gold standard featured prominently in the later part of the 19th century through World War I. Under the system adjustment placed primary emphasis on price changes. A country in balance of payments deficit would export gold in settlement of its indebtedness. As a result, money supply would decline in the deficit country and the price level would decline correspondingly. On the other hand, a country in surplus payments position received gold which raised money supply and the price level correspondingly. The increase in price encouraged imports until eventually equilibrium was restored in both the deficit and surplus countries.

The dominating characteristics of the gold standard was stability of exchange rates within very narrow margins produced by market forces without the intervention of the monetary authorities in the foreign exchange market. Besides, countries on the gold standard experienced growth in international trade although such trade was limited by the availability of gold. However, the major drawback of the system, which accounted largely for its collapse in the 1930s, was that the operation of the automatic adjustment mechanism through import and export of gold by surplus and deficit countries, respectively, precluded discretionary actions of the authorities on domestic policies. Any such action, desirable as it could be, was inconsistent with the commitment to the rules of the gold standard.

The Gold Exchange Standard

With the collapse of the gold standard at the out break of World War I only the US dollar was fully convertible into gold. This left a vacuum characterised by freely fluctuating exchange rates and exchange controls. The gold standard was restored in the 1920s, but only in a modified form of a *gold exchange standard.* Under the gold exchange standard, more national currencies were fixed in terms of gold and the currencies became "Key" currencies to which other currencies were tied and in terms of which international reserves were in part kept. Even so, it was the US dollar that remained fully convertible, at the exchange rate of $35 to an ounce of gold.

Soon there followed a scramble by each country to protect its currency and trade vis-a-vis other countries. Competitive depreciations to promote exports and curb imports, inconvertible currencies, exchange control and bilateralism became the order of the day. The Great Depression, heightened by massive flows of speculative capital, forced the collapse of the gold exchange system in the early 1930s as the United States of America, the United Kingdom and other countries abandoned the system.

The Bretton Woods System

The Bretton Woods System or the "adjustable peg" system was the decisive outcome of the meeting of representatives of 44 countries which met in Bretton Woods, New Hampshire, U.S.A., in July, 1944 in response to the need to evolve a mechanism that would correct the obvious weaknesses of the gold standard and its variant, the gold exchange standard. Under the system, exchange rates were kept stable (that is, "pegged") around declared par values but were subject to re-pegging at different levels only upon the emergence of fundamental disequilibrium in the country's balance of payments.

The adjustable peg system was designed to promote exchange stability, growth of world trade, and forbid member countries to restrict payments on current account transactions or to discriminate in their currency practices without the approval of the International Monetary Fund (IMF). Controls over capital movements, however, were permissible under the system.

The system was soon found to be inherently unstable. It depended for effectiveness on maintenance of adequate amounts of international reserves. But in the wake of slow growth or outright decline of U.S. gold reserves the financing of world trade became increasingly problematic with fixed or stable exchange rates and a commitment to international payments free of controls. Growth in international liquidity, in circumstances of declining reserves of monetary gold, had to depend on maintenance by the United States of America of balance of payments deficits and the increasing acceptance of the US dollar by other countries as an international reserve asset. The system then critically hinged on the willingness of the US to continue to run deficits. This soon led to loss of confidence in the US dollar and some countries resorted to converting their dollar holdings into gold. By 1971 the U.S. gold reserves had declined to a critical level and there were massive speculative outflows of short-term capital from the country. Consequently, by August 15 of the same year the United States suspended convertibility of the dollar into gold. The suspension thus signalled the breakdown of the Bretton Woods system.

Emergence of Floating Rates

With the collapse of convertibility arrangements, most of the major foreign currencies of the world were left to float vis-a-vis the dollar. Some countries favoured "clean" float which means floating without official intervention in the foreign exchange markets; other countries maintained the so-called "dirty" float in which emerging exchange rates in the market reflected government intervention. There were still other countries which pegged their currencies to other currencies or to a composite of currencies.

It is thus obvious from the above narrative that the origins of the present definition of convertibility were rooted in the Bretton Woods era. In that era the full convertibility status which the dollar attained in the period of the gold standard, 1870 to 1914, and its extension in the form of the gold exchange standard up to the 1930 s soon got eroded. The permission given to countries, under the IMF Articles of Agreement, to impose restrictions on capital movements is a reflection of that erosion.

PART III: EFFORTS TO ESTABLISH CONVERTIBLE CURRENCIES IN WEST AFRICA

In various parts of the world efforts have been made to arrange monetary co-operation, trade liberalisation and currency convertibility. We will only mention here briefly such efforts within the West African sub-region.

(i) Currency Arrangement Among the French-Speaking West African Countries — The UMOA Countries

On 12th May, 1961, a financial and monetary co-operation agreement was concluded between France and the French-speaking countries of West Africa. Under the agreement, the countries comprising Benin, Ivory Coast, Niger, Mauritania, Senegal, Upper Volta (now Bourkina Fasso), Mali and Togo were to form a monetary union, namely, the West African Monetary Union (*Union Monetaire l'Ouest Africaine* —UMOA)[2]

The powers of the former *la Banque Centrale des Etats de l'Afrique de l'Ouest* (BCEAO), which was established to issue currency notes and act as bank of last resort to the French-Speaking countries, were strengthened. The Bank's functions now include:

(a) issue of currency notes, namely the CFA Franc;
(b) harmonization of the credit policy of member states;
(c) management of a common pool of external reserves of the member states; and
(d) taking into account both the domestic and international money market situation and the need to minimize capital flight.

Operation: The operation of the BCEAO can be systematically stated as follows:

(a) Under the agreement with France, the CFA Franc is fixed to the French Franc and equals 0.02 of the French Franc, or 50 CFA to one French Franc.

(b) The bank pools the external reserves of all the participating countries. The reserves are held exclusively in the form of French Franc.

(c) The Bank maintains an account, called Operating Account, with the French Treasury. Payments and receipts in foreign exchange of the BCEAO are settled through this account. This system is sustained through a guarantee by France to convert an unlimited amount of the CFA Franc into French Franc. It is through this guarantee that the CFA Franc acquires convertibility outside the UMOA countries.

(d) The Bank sets comprehensive targets for the monetary aggregates to be maintained in member countries. Each country makes projections for the growth of the economy, the expected inflation rate, and the external sector position in the coming year. The budgetary financing requirements for the country are also projected. These projections are made in October of every year by the National Credit Committee of each member state and forwarded to the Bank to enable it determine the appropriate monetary targets for the entire Union and for each member state.

(e) The Bank, however, requires the agreement among member states in making changes in interest and exchange rate policies.

(ii) ECOWAS Common Currency

In an effort to overcome the problems of inconvertible currencies and trade and payments restrictions in the West African sub-region, the countries of the sub-region having come together under Economic Community of West African

States (ECOWAS) have taken some important steps towards having monetary union with a common currency that would be freely used within the sub-region and made convertible outside the sub-region. Such an arrangement is deemed necessary to promote much faster growth of intra-and inter-regional trade and, thereby, faster economic development in the ECOWAS sub-region. Pursuant to this objective, the Authority of the Heads of State and Government of ECOWAS took a decision that studies be commissioned on the possibility of creating a single monetary zone in ECOWAS sub-region. A study group was set up in September 1983.

The final report of the Study Group in April 1987 proposed a monetary zone of the West African Monetary Union (WAMU) type for ECOWAS. It proposed a transitional period of five years (1988 — 1992) before the single ECOWAS Monetary zone could be created. In that period, some non-member countries of the *L'Union Monetaire Ouest Africaine* (UMOA), including Nigeria, are required to adopt specific corrective policy measures designed to remove sources of disharmony arising particularly from exchange rate and monetary and fiscal policies of the government. The implementation of the adjustment measures by the non-members of UMOA is expected to achieve a harmonization of their policies with those that obtain among the seven member French-Speaking countries of the UMOA.

The monetary zone envisaged is based on the common currency model with the following characteristics:

(i) a common central bank;
(ii) a common convertible currency to replace existing national currencies;
(iii) pooled external reserves;
(iv) the centralisation of short-term domestic and external liabilities of national central banks in the common central bank;
(v) the re-designation of existing national central banks as branches of the sub-regional central bank; and
(vi) a convertibility guarantee agreement with the issuer of a major international currency in order to ensure stability and international confidence in the new common currency.

The proposed ECOWAS Monetary Co-operation Programme was adopted by the Authority of the Heads of States and Governments at its Tenth Ordinary Session held at Abuja from July 7—9, 1987. It decided, however, that the creation of a single monetary zone should be on a gradual and pragmatic basis.

Considerable strides have been taken by member states of ECOWAS in the bid to remove some of the disharmonies, especially with regard to exchange rates and intra-regional trade. This has been made possible through the aegis of the Structural Adjustment Programme currently being implemented by most-member states of ECOWAS. Most of the initial exchange rate adjustment recommended under the ECOWAS Monetary Co-operation Programme have since been met under the floating exchange rates arrangements adopted by various countries of ECOWAS. The exchange rate disharmonies in form of high degrees of overvaluation that featured in ECOWAS currencies other than the CFA Franc, prior to the adoption of the Monetary Co-operation Programme in 1987, have largely been removed.

It will be recalled that a multilateral institutional arrangement established for the purpose of achieving limited convertibility of ECOWAS currencies is the West African Clearing House (WACH). To give practical content to this objective, the WACH works to facilitate, among other things, increased use of national currencies to settle intra-ECOWAS transactions and promote trade. However, most of the problems impeding co-operation efforts reside here. Regretably, transactions that go through the clearing mechanism have been declining and the levels of compensable trade have also been quite low. The low levels of compensation mean that exports to member states do not compensate their imports and vice-versa, so that less and less use is made of national currencies to settle intra-ECOWAS Trade as settlement of the trade imbalance has had to be made in convertible, non-regional currencies.

Other problems have been the existence of stringent exchange control measures in some member countries and instability of members' exchange rates, which has created a disincentive for exporters to invoice their products in their local currencies whose values are falling steeply in terms of major world currencies. Problems of transportation and communication loom large, coupled with large-scale ignorance of the role and functions of WACH among group, especially bankers.

PART IV: NIGERIA'S EXCHANGE CONTROL, PAYMENTS RESTRICTIONS AND NAIRA CONVERTIBILITY

Soon after the attainment of political independence in 1960, Nigeria inaugurated a regime of exchange controls. The controls aimed at ameliorating the nation's balance of payments problems through measures designed, among others, to regulate the purchase and sale of foreign currencies and maximise the use of available foreign exchange and accommodate only essential imports of goods and services. Although the measures did achieve some of the objectives at the time, they however, reduced the usability and thus increased the inconvertibility of the Nigerian currency.

Nigeria's exchange control system was based largely on the Exchange Control Act, 1962 which replaced the Exchange Control Ordinance of 1950. The Act, among other things, prohibited all payments outside Nigeria by Nigerian residents unless with prior approval of exchange control authorities. It also enshrined the surrender requirement under which proceeds from Nigerian exports should be repatriated to the country and surrendered to the exchange control authorities within three months from the date of exports.

However, whereas the Act was applied liberally up to mid-1967, tight foreign exchange control measures were applied during 1967—1971, the period of Nigeria's civil war. In that period the Nigerian currency became increasingly inconvertible. The salient features of the control measures in the period included the allocation of foreign exchange on priority basis, accumulation of short-term liabilities in the form of approved applications for which foreign exchange was not allocated, introduction of 90 and 180-day system of payments for imports, the imposition of specific import licence and the introduction of foreign exchange budgeting in an attempt to relate aggregate foreign exchange expenditure to earnings.

The Nigerian currency recorded remarkable gains in convertibility in the era of liberal exchange control regulations — April 1972 to March 1977 and April 1980 —November 1981, and especially in the period of the oil boom, 1974-76, when Nigeria had surfeit of earnings of petro-dollars. The balance of payments position was strong and the level of external reserves was relatively comfortable. Indeed, the period saw the naira being used freely as a transactions currency in some neighbouring countries of the West African sub-region.

But the bouyant economic situation soon fizzled out in the wake of the glut in the internaional oil market. The Exchange Control (Anti-sabotage) Decree, 1977, designed to strengthen the Exchange Control Act of 1962, soon proved ineffective as well, to arrest the drain on the nation's external reserves in 1981. Therefore the Economic Stabilisation (Temporary Provisions) Act 1982 was passed to further tighten the noose on exchange controls, accompanied by other controls such as fiscal measures and import licensing, thus again imparting on the then overvalued naira a substantial dose of inconvertibility.

Severe balance of payments pressure which surfaced in 1982 worsened through 1985 as a result of increased debt service burden and accumulated trade arrears. Furthermore, there was acute shortage of inputs necessary to sustain industrial production to a satisfactory level. The naira was then generally believed to be over-valued in both nominal and real terms against the US dollar and other major world currencies. Such over valuation of the naira was one of the price distortions and disequilibrium in the economy which the Structural Adjustment Programme (SAP) introduced in July 1986, sought to correct.

Under the Structural Adjustment Programme exchange control on current transactions and import licensing were abolished. A second-tier foreign exchange market where the naira exchange rate was to be determined by market forces was established. A step was taken further in deregulating the foreign exchange market in July 1987 when the first and second tier markets were merged and deregulated. Another deregulatory measure taken in this regard was the abolition of the regulation which required exporters of non-oil exports to surrender the proceeds to the Central Bank of Nigeria. Effective from January 1987, such exporters were allowed to retain 100 per cent of their export proceeds which, however, must be placed in domiciliary account with a bank in Nigeria. The owner of such an account can withdraw from the account any time to pay for eligible transactions. Moreover, in pursuit of the deregulation policy under the SAP, the number of banned import items was reduced from 74 to 16.

Thus, since September 1986 the naira has acquired considerable degree of convertibility. However, the naira cannot correctly be described as a convertible currency. This is because the preconditions for the convertibility of a currency have not been fully met. For instance, because of the inadequacy and precariousness of the external reserves, there are still some elements of exchange control even for current transactions. Foreign exchange is still being rationed while the parallel market looms large in the system. Considered against the background of the high rate of price inflation, speculative activity, and the huge unsatisfied demand for foreign exchange, the naira exchange rate is probably still not quite realistic, but much nearer the realistic level now than before the SAP.

PART V: POSSIBILITY AND IMPLICATIONS OF NAIRA CONVERTIBILITY

It is generally agreed that since the introduction of the Structural Adjustment Programme (SAP) in the middle of 1986, the naira has acquired a considerable degree of convertibility. The liberalised trade and exchange regimes have no doubt moved the currency forward on the path that could lead to its convertibility, at least, in the long-run.

However, there are several conditions which are prerequisites for the convertibility of a currency that are absent in Nigeria's present economic environment. These include a strong economy with a diversified export base, adequate external reserves relative to demand, realistic exchange rate, free trade and exchange policy, etc. These are discussed briefly below.

Economic Strength

The Nigerian economy has been experiencing a serious depression since 1981 when the international oil market collapsed. In spite of government efforts to revive and strengthen the economy by adopting the Structural Adjustment Programme since 1986 and the significant achievement under the programme so far, the economy today is, no doubt, still depressed. Moreover, the economy still relies critically on a single commodity (petroleum) for foreign exchange earnings and therefore lacks a diversified export base.

External Reserves

The external reserves of the country are far from being adequate. For instance, from 1981 to the first five months of 1989 the country's external reserves were much below the minimum international convention for reserve adequacy. Whereas the international convention requires a minimum of four months of imports, our reserves in 1981-1988 could only finance an average of 1.8 months of imports and 2.9

months in the first five months of 1989 (see Table below).

EXTERNAL RESERVES AND MONTHS OF IMPORTS THEY FINANCE

	Average Monthly Import ($) Million	*Reserves ($) Million*	*No. of Months of Imports*
1981	2203.6	3807.2	1.7
1985	977.0	1641.8	1.7
1986	628.1	1081.6	1.7
1987	442.7	1121.2	2.5
1988	458.5	611.4	1.3
1989*	386.7	1116.4	2.9

* January to May 1989

The fact that foreign exchange is being rationed today is another testimony to its inadequacy relative to demand. Moreover, because of the continued glut in the international oil market, our balance of payments is persistently under heavy pressures, making the achievement of equilibrium extremely difficult. The problems of the external sector will persist until the export base is diversified.

Free Trade Policy

With the abolition of exchange control and import licensing and other restrictions on trade under the SAP a major step had been taken towards naira convertibility. However, because of the consideration for balance of payments, some controls are still retained not only for capital transactions but also for current transactions. For instance, foreign exchange is still being rationed while the use of funds in domiciliary accounts is limited to eligible transactions.

Exchange Rate Policy

Under the current exchange rate policy, the value of the naira is determined by market forces of supply and demand. The Central Bank of Nigeria calls for bids from authorised dealers on a daily basis and the available foreign exchange is sold to them at the price determined at the auction. Nigeria operates a managed floating exchanged rate regime under which some form of government intervention in the determination of exchange rate is adopted in order to ensure its orderliness and stability. Such intervention has been exercised occasionally through buying and selling of foreign exchange in the market and through the adoption of appropriate monetary and fiscal measures.

The floating of the naira has succeeded in removing its over-valuation which marked it in the pre-SAP era. The efforts now being made to set up *bureaux de change* all over the country are another major step towards further deregulation of the exchange market.

Implications

(i) **Costs**

It was mentioned somewhere in Part I that a prominent cost involved in currency convertibility is the reduction of policy options available to government to deal with a serious adverse balance of payments development. The government can no longer impose direct controls such as exchange control or import licensing, nor directly manipulate the exchange rate. It could, however, still intervene indirectly by taking monetary and fiscal policy measures which are generally slow in having the desired impact.

(ii) **Benefits**

The benefits a country could derive from the convertibility of its currency are quite obvious. They have been discussed in Part I. They will only be mentioned here briefly for purpose of emphasis. Foremost among the benefits is the potential for trade expansion. The more convertible the naira is, the more the scope to expand trading activities between Nigeria and other countries. The increased trading activities will result in increased production, diversification of the export base and expansion in intra-regional trade.

As a result of trade liberalisation and a more efficient allocation of resources, investors will be encouraged to invest in the economy. The perception of the area as a potential market and the fact that returns on investment could be repatriated without being subject to restrictions, make the economy attractive to foreign investors. Increased direct investment would also help to increase the domestic production of goods and services needed in the economy.

In countries with convertible currencies, unofficial markets for foreign currencies are not significant nor widespread. Market mechanism allocates available foreign exchange and there are hardly unsatisfied demands from official sources to warrant a recourse to parallel markets. Smuggling of agricultural and manufactured goods tends to be minimised under convertible currency regimes. Also, capital inflow tends to be boosted through the maximisation of desired investment and output.

The analysis thus far indicates clearly that making the naira a convertible currency is not only desirable but is also consistent with the current policy stance of government. However, the analysis also does indicate that formidable problems loom large on the paths to the internationalisation of the currency. These include the under-development and the current depression in the Nigerian economy as well as the structure of the economy which lacks a diversified export base. Others are inadequate external reserves, the persistent balance of payments problems, as well as the persistent high rate of inflation. Until these problems are solved, the naira cannot become a convertible currency.

PART VI: SUMMARY AND CONCLUSION

The paper has discussed the possibility of internationalisation/convertibility of the naira with a view to assessing what the authorities still have to do in order to make it convertible in the medium to long-term. The conditions precedent to convertibility were identified as the existence of a realistic exchange rate determined through market forces and free of discretionary manipulation by the monetary authorities; a liberalised trade regime under which restrictions are disallowed on current international transactions; the maintenance of adequate foreign exchange reserves supported by a diversified export base; and balance of payments equilibrium.

The evolution of currency convertibility on a global basis as well as the efforts to establish convertible currencies in the West African sub-region were reviewed. The review shows the difficulty of achieving and sustaining full currency convertibility. A new definition of convertibility which permits the imposition of restrictions on capital international transactions emerged at the Bretton Woods arrangement. The review also shows that the convertibility of the CFA Franc is sustained mainly by the guarantee of the French authorities while the achievement of the proposed common and convertible currency for ECOWAS has many difficult hurdles to overcome before it is achieved, if ever it will be achieved.

The alternative and perhaps more viable proposition is the one whereby Nigeria has to make the naira convertible through independent efforts. The approach is propitious since the liberalised exchange and trade policies being currently pursued by government through the Structural Adjustment Programme have succeeded in putting the naira on track towards convertibility. However, several of the conditions which are necessary for the establishment of a convertible currency are yet to be fulfilled in the Nigerian economy. These include a strong economy with diversified export base, comfortable level of external reserves, realistic exchange rate, and reasonable price stability. The internationalisation/convertibility of the naira will continue to be severely limited so long as these problems remain unresolved.

It is hoped, however, that within the perspective planning horizon of say 15-20 years, the naira has a good chance of acquiring most of the attributes of a convertible currency, especially if the current policy of liberalisation continues and the objectives of the structural adjustment programme are realized.

NOTES

1. As spelt out by the Fund's Articles of Agreement, current international transactions include:
   - (a) all payments due in connection with foreign trade and normal short-term banking and credit facilities;
   - (b) payments due as interest on loans and as net income from other investments;
   - (c) payments of moderate amounts for amortization of loans or for depreciation of direct investments;
   - (d) moderate remittances for family living expenses.
2. Mali which formerly withdrew from the agreement was readmitted in 1984 while Mauritania abandoned the Union in 1972. Togo acceded to the Agreement on 27th November, 1963.

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