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JOHN ATTIPOE "MULTIPLE EXCHANGE RATES IN GHANA AND NIGERIA, EXPECTATIONS, EXPERIENCES, PROSPECTS — AN ECONOMIC ANALYSIS" UNIVERSIDAD DE GOTINGA, JULY 1987: 72 PAGES

The paper is a simple, straightforward and concise analysis of the multiple exchange rate system adopted by Ghana and Nigeria after the abandonment of their respective single rate regime. The paper sought to examine the new system from the theoretical and practical perspectives, as well as attempt an analysis of the implications and prospects of its operation in the two economies. The author based his empirical analysis on the first three months of the introduction of the scheme. For ease of reference, the author divided the paper into three Chapters. Chapter one contains an exposition of the theory on multiple exchange rates in general; while chapters two and three examined the operation of the new system in Ghana and Nigeria, respectively.

Preceding chapter one of the paper, and coming immediately after the introduction, or precisely pages 2–4, is a section which presumably stands alone. Its content includes the broad definition, description and functions of the multiple exchange rates which infact provided the basis for the subsequent theoretical analysis in chapter one. Titled "theoretical reflections," chapter one has two parts. In the first part, the author aimed at highlighting the advantages or functions of a dual rate system towards achieving some macro-economic policy objectives. He summarised these functions as:–

(a) **Balance of payments adjustment.** This becomes necessary whenever a disequilibrium occurs. The resulting imbalance is then corrected (depending on its source(s) by manipulating the rates in such a way as to achieve at least one of the following:

(i) restrain import, and boost exports;
(ii) promote non-traditional exports;
(iii) promote exports in general;
(iv) promote essential imports;
(v) curb imports of consumer goods.

(b) **Taxation and subsidisation of trade.** By operating the multiple rate system, government could earn some revenue. This could be made possible by assigning a high market exchange rate for imports and low official rates for exports. The difference between the market and official rates represented by the depreciation serves as the tax on imports. This implies that every foreign exchange purchased by importers at the high market rate would generate import tax revenue insofar as the Central Bank is conducting the sale. The loss in revenue suffered by exporters when they have to exchange their export proceeds at the lower official rate rather than the high market rate constitute an export tax revenue to government.

On the contrary, the loss in revenue by government to exporters and importers through a reversal of the foregoing process is referred to as subsidisation of trade.

(c) **Protection.** This entails assigning high exchange rate to imports thus rendering them less competitive in the domestic market. The consequence therefore, is a switch of demand from imported items to their local substitutes thus leading to increased production by import substituting industries.

(d) **Stabilisation of domestic prices.** The dual rate system could bring about stabilisation of prices. One of the ways to achieve this is by assigning low exchange rates to imports and high rates to exports, thereby promoting imports which will eventually dampen the level of prices in the domestic market.

However, in the second part of the analysis, the author focused on the practical limitations or problems that could be encountered in the operation of a dual rate system especially if it was expected to pursue multiple objectives. These problems were analysed under two sub-headings as follows:

(a) **Conflicting objectives.** Through illustration, he was able to show how an attempt at solving one problem through the manipulation of these rates could lead to another. He nonetheless concluded that the use of multiple rates alone to meet many objectives at the same time can only be successful if other complementary measures are put in place.

(b) **The search for a realistic exchange rate.** Another problem that hinders the achievement of some policy targets in a dual rate system is the inability by operators, to determine a realistic exchange rate structure. Oftentimes, the rates arrived at are biased and not representative of the true situation.

However, sub-head (c) which was also considered under this section provided a general definition of purchasing power parity (PPP). It also analysed its use in the determination of equilibrium exchange rate and the limits or constraints associated with its application in practical terms.

Equipped with this theoretical background, the author went on to examine the operation and impact of the dual rate system on the economies of the two countries. His analysis in this regard came under two broad headings. First, he commenced by stating the genesis of issues which gave rise to the establishment of the system in each of these countries and secondly, he discussed the auction system as practiced under three sub-heads:

(a) Objectives
(b) Early reactions and
(c) Features of the system.

With respect to Ghana, the author was able to identify inflation, overvalued local currency and shortages in domestic production resulting in excessive pressure on the balance of payments, as some of the problems confronting the economy before the introduction of the new system. He carefully enumerated efforts made by government to revamp the deteriorating economy which amongst others included a series of devaluation of the local currency under the Economic Recovery Programme. Yet, the problem persisted even after the currency had undergone an approximate of 3,200 per cent devaluation between 1983 and January 1986. Therefore, rather than risk further outright devaluation, the authorities opted for a gradual devaluation under the auction system.

While discussing the auction system, he aptly summarised its objectives as:

(i) to arrive at an exchange rate that would be much closer to the black market rate than to the official rate with the hope of crowding out the black market;

(ii) to encourage Ghanaians to explore the export potentials of the country;

(iii) to enable the government derive substantial profit from the sale of foreign exchange to ease its cash-flow problems; and

(iv) to liberalise trade.

In order to achieve these objectives, the dual rate system was structured such that the official rate (Window I) was fixed permanently, while the market rate (Window II) was allowed to float. Transactions permitted through Window I covered revenue from cocoa exports, government debt servicing, and imports of crude oil and essential drugs. Window II on the other hand, was applied to a wider range of transactions. These included essential imports – capital goods, spare parts, industrial raw materials, intermediate goods, etc. – and also, exports, invisibles and capital movements. All other imports, especially consumables were totally excluded from the dual rate system. The author critically examined the goals the new system was set to pursue, and having regards to standard theoretical expectations, he observed some areas of conflict:

(a) the exclusion of imports of consumables from the system inflamed activities in smuggling and also heightened black market transactions in foreign exchange giving rise to high price for it. Consequently, the black market rate became more competitive and attractive to customers who wanted to convert foreign currencies into Cedi. As a result, the original intention to crowd out the black market was defeated.

(b) the restriction on essential imports through high exchange rate contradicted government intention to encourage non-traditional exports since most of the items in this group of exports depended on imported inputs for their production.

(c) the protection sought for local industries through assigning high rates to most imports, was a negation of the liberalisation objective of the system. Worried by these contradictions and other shortcomings, he wondered why the scheme was set up at all in Ghana. He argued that if the motive was only to effect devaluation or that the government wanted a forum for proper allocation of scarce foreign exchange or that the government wanted to earn some revenue from exchange profit, then the need for the dual rate system can hardly be justified since a single floating rate system can also satisfy any of these motives. He then submitted that a single floating rate system would be more suitable to Ghana's economy.

In the case of Nigeria, the author identified balance of payments problem and over-valuation of the local currency as the major factors responsible for the adoption of a dual exchange rate system. He briefly reviewed the balance of payments developments in Nigeria during and after the oil boom era. The oil boom period he narrated, was characterised amongst other things by an enormous expansion in oil earnings, rapid growth in imports, sharp rise in the value of the naira, and a substantial growth of the reserves. Consequently, the balance of payments position was healthy for most of the period. However, by 1981 when the boom was over, Nigeria started experiencing chronic balance of payments deficits occasioned by dwindling oil receipts, high demand for imports and mounting external debt. In apparent response to redress the situation, government from time to time came up with stringent economic measures directed at quantitative control on the level of imports and indeed, the general reduction of pressure on the balançe of payments. These measures were proved inadequate in that the pressure on the external sector continued owing to Nigeria's high propensity for imports which was sustained by over-valued exchange rate. The issue of over-valued naira became a matter of concern to both Nigerians and non-Nigerians alike. Inter-institutions like the International Monetary Fund (IMF), Creditor Banks, etc. called on Nigeria to devalue her currency as a means of salvaging the deteriorating situation. The call was initially resisted due to socio-political reasons. However, as the economic situation worsened, government had to introduce the dual rate system to mitigate the pressure on the balance of payments.

The author was not able to state clearly the objectives of Nigeria's dual rate system because he claimed they were not released in the official guideline on SFEM at the time of his writing. However, he assumed the devaluation motive was behind the setting up of the scheme. Furthermore, he described the dual rate system as made up of the lower official rate which belongs to the first-tier foreign exchange market and the higher market rate which belongs to the second-tier foreign exchange market otherwise known as SFEM. Both the official and market rates were flexible. Transactions through the official rate were limited to government debt repayments and contributions to international organisations. All other transactions including imports and exports, capital transactions, invisibles etc., were covered by the market rate. Constrained by the absence of a set of goals the system was meant to achieve in Nigeria, the author assessed the new scheme on likely theoretical targets it was supposed to achieve such as balance of payments adjustment, promotion (and subsidisation) of non-oil exports, restraining imports, protection etc. He concluded that by assigning high exchange rate to both imports and exports, and since the aforementioned targets could be conveniently achieved through a high rate system, he was sure that the dual rate system would be retained in Nigeria for the foreseeable future. However, he quickly added that the gains of a dual rate system are often short-lived. Thus, for a long lasting benefit, he suggested that the two rates should merge as soon as the economy had recovered enough so that a single high rate which can firmly consolidate the gains of the dual system is retained.

The introduction of the dual exchange rate system in Ghana and Nigeria, brought into prominence the effectiveness of an adequate exchange rate system as a potent balance of payments policy instrument. The novelty of its introduction generated a lot of comments or articles by economists and non-economists alike as to the desirability or otherwise of its operation. This paper under review is one of such articles. Probably in his desire to reach a wide readership, the author painstakingly presented his analysis in very clear and simple language devoid of lavish use of words or complex analysis. In fact, the methodical presentation coupled with the simpleness of the texts, made the article very easy to understand and appetising to read. Also of particular importance is the quality and scope of the theoretical framework which was consciously limited to materials actually relevant to the theme of the paper with utter exclusion of cumbersome or irrelevant details. Furthermore, one gathers from the paper that even though the two countries operated the dual rate system, there were areas of dissimilarities. This alone has set the stage for subsequent work on the comparative analysis of the operation of the system in Ghana and Nigeria.

Although elegantly presented, the paper contained some shortcomings which could be analysed as follows. The section which contains general definition and description of the multiple exchange rate system should be in the beginning of chapter one since it bears direct relevance to that chapter. Similarly, sub-head (c) of page 19 should also be incorporated into the section on general definition. The value of a currency cannot fall below zero and as such its devaluation cannot exceed 100 per cent. So, the sentence on page 25 which goes thus: "In all, the Cedi has undergone a total devaluation of approximately, 3,200 per cent in the period is misleading and therefore should be expunged. For a topical issue as this, it is considered rather inadequate to limit empirical investigation to a very short period of three months. This situation constrained the author's ability to properly appraise the system due to inadequate information. For instance, because of the probable contradicting objectives the system in Ghana was set to achieve, the author was sceptical about its successful operation and ability to stand the test of time. But so far, the scheme has lasted more than two years and there is no indication of its abandonment. In the same vein, the Nigerian version has undergone series of changes aimed at improving its performance. Thus, there is need for the author to revisit the topic so as to incorporate these new changes and developments that have kept the system going.

Finally, I wish to commend the author for his effort in putting the paper together. I strongly feel that economists and non-economists will find the theoretical frame-work very useful. On the operation of the system in the two economies, I believe that enough information must have been generated after over two years of its implementation. Furthermore, the original work of the author could be further enhanced with the incorporation of the foregoing suggestions.

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