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Foreign Exchange Management in Nigeria: The Journey So Far

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The management of foreign exchange in Nigeria has come a long way from the days of the military regimes when exchange rates were determined by military fiat up till now when there appears to be some semblance of stability in the value of the Naira. It is, however, a matter of regret that this seeming stability has come at a great cost. The value of the Naira has gone through thick and thin, through devaluation, revaluation, and some other methods of extrapolation. We have devised several forms of exchange rate contraptions in a bid to finding the right method of exchange rate determination without success. It is sad to note however, that most of the trial-and-error modes were due to the selfishness of our corrupt leaders and policy formulators. This paper has, therefore, tried to highlight some of the past challenges in our foreign exchange management, and offer some suggestions for the way forward.

Keywords: Foreign Exchange Management, Exchange Rate, Foreign Currency, Authorized Dealers, Dutch auction.

PREAMBLE

The concept of the origin of money from the batter days for real money is the same concept that led to the introduction of Foreign. Exchange from local currency to the foreign currency/exchange. The difference is just the foreign element. As the local currency helps in the payment for local trade, so is the foreign exchange/currency in the payment for foreign trade.

2.0 INTRODUCTION

Foreign Exchange therefore is the relationship or ratio of one currency to another currency. Generally there are four macro markets in an open economy; these arethe financial, labor, goods and services and foreign exchange with prices for each as interest rates, wages, prices and exchange rates respectively. The interaction of these four keyelements in an economy determines and stabilizes the level of each and the entire four. Exchange rate, therefore, like the other three is dependent and interrelated with the others.

3.0 CONCEPT OF FOREIGN EXCHANGE MARKET

Foreign Exchange is the means of payment for international transaction or foreign trade. As we all know that no country is an island to itself. We buy and sell goods and services to and with other countries. Such goods and services must be paid for in a particular standard of exchange. Some currencies are generally acceptable as convertible currencies, these include the currencies of the industrialized countries or the GT. Some of these currencies includes:

The US Dollar
The Pound Sterling
The Canadian Dollar
The Euro
The Japanesse Yen etc.

3.1 THE FOREIGN EXCHANGE MARKET

This is just the medium of interaction between the buyers and sellers of Foreign Currencies by way of payment for transactions or by physical exchange of currencies. It is not limited to any particular location. It can take place anywhere and in any form.

3.2 PARTICIPANTS IN THE MARKET

The participants are numerous. These include anybody that has an interest in foreign trade either directly or indirectly. Therefore the Central Bank or Ministry of Finance is an interested party as they regulate the market. They are also participants as they are on the supply side. The banks are theAuthorized Dealers. The Bureau de Change (BDC) is also a participant.

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3.3 THE EXCHANGE RATE REGIMES

The value of a country's currency will depend on a number of factors viz: state of the economy, value/volume of exports, balance of trade/payment, the level of domestic production, size of external reserves. In a free market economy, the exchange rate will be determined to a great extent by the forces of demand and supply. However, the point must be made that there is no currency that will be totally left to the forces of demand and supply. There must be controls or interventions by the regulatory authorities.
Therefore the various regimes of exchange rate systems include:

i. The Free Floating Rate Regime
ii. The Fixed Exchange Rate Regime

In between these two are:

a) The Managed Float: This system is determined not absolutely by the forces of demand and supply but occasional intervention by the regulatory authorities. There will be a band of lower and upper limits within which the rate will be allowed to float.
b) Adjustable Peg System:This is the fixed exchange rate system, but will be subjected to adjustments from time to time because of the forces of the market (supply and demand).

The difference between the various systems or regimes is just the difference between six and half-a-dozen if operated effectively or efficiently.

3.4 OBJECTIVES OF EXCHANGE RATE POLICY

- To maintain domestic policy stability
- To ensure favorable Reserves
- To achieve a favorable balance of payments
- To preserve the value of the domestic currency.

4.0 FOREIGN EXCHANGE MARKET MANAGEMENT IN NIGERIA

4.1 PARTICIPANTS

The following participants operate in the Nigeria foreign exchange market:

A. THE CBN

This is the regulator of the foreign exchange market as well as the representative of the Federal Government providing the

required enabling environment for the market. The major functions of the CBN in the market include, but not limited to, the following:

- ❖ Establishing the ground rules of the market.
- ❖ Enforcing the rules governing the allocation of foreign exchange.
- ❖ Determining the auction system
- ❖ Enforcing exchange control regulations
- ❖ Providing the foreign exchange for each bidding and ensuring allocation of successful participants
- ❖ Advising the Government on the developments in the market
- ❖ Enforcing discipline among erring foreign exchange market participants.

B. AUTHORIZED DEALERS

These are institutions that are authorized to bid for foreign exchange at the CBN's periodic foreign exchange auction programs

and or can buy and sell foreign exchange but cannot participate in the CBN's biddings. They are equally authorized to sell and buy

foreign exchange to and from authorized buyers and autonomous sellers. In Nigeria, the authorized dealers are the Banks and

Bureau De Change (BDCs). While the banks can participate in the bidding sessions of the CBN and can engage in money transfer

service as well as correspondent banking, the same is not true of the BDCs.

C. AUTHORIZED BUYERS

There are institution that are allowed to buy foreign exchange from holders, but not authorized to sell and cannot participate in the

CBN's foreign exchange bidding programs. Authorized buyer can, however, sell their foreign exchange holdings to the authorized

dealers or keep such in foreign currency domiciliary accounts which must be maintained with any of the authorized dealers.

Examples of such buyers are Hotels, Tourists centres, Ticketing Companies, individuals, etc.

D. FOREIGN CURRENCY DOMICILARY ACCOUNTS

The introduction of the foreign currency domiciliary account into the nation's foreign exchange system was aimed at:

- ❖ Encouraging Nigerians who have foreign accounts to repatriate and invest same in the Nigerian economy.
- ❖ Creating investment opportunities compared to the existing ones in the countries of the foreign currency domiciliation; and
- ❖ Easing the effects of bottlenecks in the process of applying for foreign exchange in financing the importation of raw materials for exports.

4.2 DETERMINATION OF FOREIGN EXCHANGE RATE IN NIGERIA

The determination of foreign exchange rate in Nigeria has traversed two main mechanisms: the fixed and flexible.

4.2.1 FIXED EXCHANGE RATE REGIME (BEFORE SAP)

Nigeria practiced fixed exchange rate system from independence in 1960 up to 1986, which meant that the value of the local currency in foreign currencies was administratively fixed by the CBN. However, the fixed exchange rate policy was implemented using different systems depending on the situation of the economy at that time. (Ahmad and Zarma, 1997). One of the systems used was that of maintaining parity with the Pound Sterling. This parity was determined using the gold content of the Nigerian Pound. At the time this approach was in force, the gold content of the Nigerian Pound was the same with the Sterling Pound until the change of the Nigerian Pound to Naira. Consequent upon this, the pound Sterling was fixed at 0.58 to N1.00.Between 1971 and 1974, the gold content approach was changed to Dollar peg. This was in response to the suspension of the convertibility of the Dollar into gold, as a result of the crisis that occurred in the international financial system, which led to the devaluation of the Dollar. Using this approach, the US Dollar / Naira exchange rate was fixed at N1.0 to USS1.52.

In 1978, the Import-weighted Basket approach was adopted. This was similar to the IMF standard basket method of SDR. The weights were based on the relative share of the countries whose currencies were included in the basket as per 1976 total imports. The currencies in the basket where the US Dollar, the Japanese Yen, the Pound Sterling, the Deutsche Mark, the French Francs, the Swiss Francs and the Dutch Guilder.

4.2.2 POST SAP PERIOD (1986-DATE)

4.2.2.1 DUAL AND UNIFIED EXCHANGE RATE SYSTEMS

In September 1986, the Naira was floated under the Second – Tier Foreign Exchange Market (SFEM). At its commencement, a dual exchange rate for the allocation of foreign exchange was adopted, in which transitional transaction items such as: debt service payments and official transfers were settled at the first- tier rate. The SFEM witnessed several changes, with constant fine-tuning of the operational modalities in order to ensure a stable and realistic exchange rate of the Naira.

4.2.2.3 The autonomous foreign exchange market (AFEM)

Was introduced in 1995 in order to redress the distortions occasioned by the introduction of a fixed exchange rate regime under the Abacha Administration. The AFEM was the window which catered for the foreign currency needs of private economic agents. It operated side-by-side with the official foreign exchange window in which the exchange rate was fixed. The AFEM was introduced to minimize market distortions. The AFEM witnessed less demand pressure because of its numerous documentation requirements; as a result, the exchange rate was relatively stable. However, the Naira generally was very volatile in the parallel market during the AFEM system.

4.2.2.4 INTER-BANK FOREIGN EXCHANGE MARKET (IFEM)

In October 1999, there was a transition from the AFEM to IFEM. In the AFEM, the CBN was a major source of supply of foreign exchange while the authorized dealers only purchased on behalf of their customers at the rate determined by the Bank. Despite relative stability was maintained in the AFEM, the need to broaden and deepen the foreign exchange market prompted the introduction of the IFEM. The market was envisaged to be purely private sector funded. In terms of performance, a review of developments in the IFEM revealed that stability prevailed at the inception. However, exchange rate instability re-emerged as a result of the persistent expansionary fiscal policy and excess liquidity in the system.

4.2.2.5 THE INTRODUCTION OF THE DUTCH AUCTION SYSTEM

Consistent with the objectives of enhancing efficiency in the foreign exchange market, achieving a realistic exchange rate for the naira and narrowing the gap between the official and parallel market rate through market-based determination of the exchange rate, the CBN re-introduced the Dutch Auction System in July, 2002. According to the guidelines for operating the system to all authorized dealers, the CBN indicated that it would thenceforth intervene in the foreign exchange market through the system whereby the authorized dealers would submit their customer's bids on specified days of the week and CBN reserved the right of reject bids that were deemed to be unrealistic and/ or any application that contravened foreign exchange regulations.

Under the system, authorized dealers are to ensure that they have an adequate Naira cover on their current account with the CBN. Funds purchased from the CBN are to be used for eligible transactions only.

There are two options under DAS, namely:

a. Retail option (RDAS); and
b. Wholesale option (WDAS)

Retail option was adopted up till February 19, 2006. The process of determining the Naira exchange rate under the RDAS entails the following steps:

I. CBN will release circular to all authorized foreign exchange dealers to send in their bids in diskettes based on their customer's demands. The bids to reach CBN on or before 12:00pm.
II. Banks respond by sending bids in diskettes on or before 12:00pm
III. CBN consolidates the bids in its Lagos office and sends same electronically to its Head Office in Abuja for further processing.
IV. The ruling rate is the marginal rate that clears the supply at any given time. This is obtained by collating all bids from the highest to the lowest that will mop up the applicable supply (e.g. $100 million) of foreign exchange at the time.
V. Supply can be increased marginally to accommodate the demands that fall within the marginal rate.
VI. The transaction is carried out twice every week.
VII. Bids are done on customer's accounts and they are backed by an equivalent amount in Naira.

In addition to the objectives that guided the introduction of RDAS, the WDAS is aimed at:

- Further liberalization and development of the foreign exchange market to facilitate the convertibility of the Naira.
- The unification of the exchange rate between the official and interbank markets and to resolve the multiple currency problems.
- Facilitating greater market determination of exchange rates for the Naira vis-à-vis other currencies.
- Promoting the efficient and smooth functioning of the foreign exchange market as well as achieving a stable and realistic exchange rate.

Under the revised guidelines for the operation of the foreign exchange market issued by the CBN on February 16, 2006, the CBN would henceforth participate in the foreign exchange market to sell foreign exchange through the WDAS. The authorized dealers would submit their bids in a prescribed format for any auction session between 8:30 am and 10:20am on the day of the auction. Under the new revised guidelines, authorized dealers are expected to strictly observe the Net Open Position (NOP). Exceeding the approved NOP, according to the guidelines, would attract appropriate sanction, including withdrawal of Authorized Dealership License.

Apart from the introduction of WDAS, the CBN also took some measures and strategic initiative to liberalize the foreign exchange market. The main strategy was to ensure an increased supply for foreign exchange to all markets and also remove access restrictions to the official market thereby reducing the demand pressure on the parallel market. The ultimate objective was to facilitate a convergence between both markets as well as to achieve a single exchange rate for the Naira. Some of the initiatives/measures included:

- A 100 percent increase in business and personal travel allowance (BTA and PTA)
- Bureau de Change (BDC) operators were permitted to source foreign exchange from the official market (from and through the banks) as well as the CBN. They were also to serve as brokers within the inter-bank market framework and, in addition, affect the transfer of foreign exchange through their domiciliary accounts with commercial banks.
- Banks, Travelex and other authorized dealers were also allowed access to statutory guidelines.
- CBN introduced a cash swap system whereby it would sell foreign exchange to some designated banks to be repurchased in future.
- Simplified foreign exchange procurement documentation of overseas medical treatment and payment of school fees. Banks were allowed to operate BDC window as part of their financial product offering.

5.0 LIMITATIONS OF FOREX MARKET MANAGEMENT IN NIGERIA

The Management of the Forex market in Nigeria has had a lot of challenges and limiting factors over the years. Some of these limitations include, but not limited to the followings.

i. Imbalance in demand and supply of foreign exchange currencies. This is a major challenge in almost all developing countries. However, our peculiar situation in Nigeria is more acute because we rely heavily on imported goods. This is closely related to the issue of adverse balance of trade and payment with our trading partners.

ii. Another limitation to our Forex management is due to our monolithic economic base. We rely heavily on oil as our major source of foreign exchange earnings. Before the advent of oil in Nigeria, our economy was doing quite well with Agricultural product such as Cocoa, Rubber, Cotton, Groundnut etc. driving our Forex earnings. This has changed drastically since the discovery of oil, the Agric sector has been neglected and Forex earnings from that sector lost.

iii. Again, Nigeria has become an import-dependent nation because of our new found sudden wealth in oil. We now import virtually everything ,including consumer goods and luxury goods that we can easily do without.

iv. Another limitation is the inconsistencies in government policies that have hampered progress in industrialization. Most of our industries have collapsed over the years, thereby contributing/compounding our import-dependency.

v. Corruption is another challenge or limitation in our Forex management. Most of our leaders prefer to steal our money and keep such in foreign account outside Nigeria. Such monies are not available for the needed developmental projects that could generate employment or even generate further Forex. This reduces the supply end and increases the demand train.

vi. Unnecessary Foreign borrowings by our governments over the years. Most of the repayment of these loans will be done from our meager Forex earnings and we pay interest at very high rates thereby eroding Foreign Reserves the more.

vii. Financial and Fiscal indiscipline are another limitation in our Forex market Management. Our borders are porous and a lot of corruption is evident. Goods that are not expected to come into the country find their ways in thereby denying us of revenue and Forex.

viii. Lack of economic and financial independence from our colonial master. Most of our financial and economic policies are dictated to us by the western world. These policies are designed to weaken our economic and financial sector. Such policies are forced down our throats and these task masters pretend to be doing us some favor.Our leaders and economic advisers condescend to agree with them even when they know that such policies are not in our interest. This is done because of their inherent personal financial gains or some hidden political/economic agenda.

ix. The Naira is not a convertible currency and so it clings to the apron-string of one/more of the major currencies, e.g. the dollar and or Sterling Pound; any adverse change in the rate of such currencies directly affect the Naira whereas positive change are not reflected in the Naira exchange rate. So it is a question of when the Dollar or Sterling sneeze, the Naira catch cold.

6.0 CONCLUSION

The conclusion of this paper will be that all those identified challenges and limitations be removed without delay, i.e.

i. Block our porous borders
ii. Revitalize our industries.
iii. Resuscitate our Agric sector
iv. Be consistent with our best economic and financial policies, and do away with the bad ones.
v. Fight corruption to a stand- still in our national life
vi. Ban the importations of consumer/Luxury goods
vii. Refuse to take dictation from the western world, especially in respect to policies that would have adverse effects on our economicand financial structure.
viii. Our Economic and Financial advises / leaders should be sincere and devoid of hidden agenda or selfish personal interest.

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