THE MANAGEMENT OF FOREIGN EXCHANGE RESOURCES UNDER NIGERIA'S STRUCTURAL ADJUSTMENT PROGRAMME*

BY

DR. M.O. OJO**

Abstract

The paper seeks to appraise the foreign exchange management strategies under the Structural Adjustment Programme (SAP) in Nigeria. As a background, it reviews the foreign exchange management strategies in the pre-SAP period which largely relied on the use of trade and exchange controls. The available evidence is that the use of the control tools contributed to some extent to reducing balance of payments deficits, but at high costs in the form of increased malpractices and constraints on the production process. The associated over-valued naira exchange rate discouraged production for export, encouraged imports of finished goods and raw materials and gave rise to virile parallel foreign exchange markets. On the other hand, foreign exchange management under SAP has relied substantially on free market forces in a generally deregulated economic environment. The effects have been the significant elimination of the over-valuation of the naira exchange rate, boost to non-oil exports and the balance of payments. The main outstanding problem has been the persistent depreciation of the naira exchange rate,as well as its instability. The underlying factor is the weak export base in the midst of strong demand for foreign exchange. The paper concludes that with the uncertainty in the outcome of the efforts to expand the export base coupled with high debt burden, there would be need to review national development strategies such as would reduce the dependence of the Nigerian economy on external trade in the long-run.

Introduction

Foreign exchange earnings from international trade transaction and external aid are vital for the economic transformation of less-developed countries (LDCs). All other things being equal, foreign exchange resources so earned can induce increased factor supplies and promote the development of technical skills and knowledge all of which should enhance domestic capital formation and economic growth. Consequently, the role of foreign exchange has traditionally been a critical element in the development planning process of LDCs.

Between 1960 and 1985, Nigeria went through varying development experience which required prudent management of available foreign exchange resources. Inadequate foreign exchange was a major constraint in the execution of the First National Development Plan, 1962 - 1968, a situation that was accentuated by the prosecution of the civil war between July 1967 and January 1970. Resource management could be considered fairly adequate for the needs of the period. The period 1970 - 1980 witnessed a dramatic improvement in Nigeria's foreign exchange position following the substantial increases in crude oil prices in 1973/74 and 1979. However, foreign exchange management appeared too short-sighted in nature with the result that it took little cognisance of possible long-term developments in the world economy. Following the collapse of the world oil market in the early 1980s, Nigeria once more entered a very tight foreign exchange position especially in the context of previous commitments. Resource management initially was conceived in terms of finding short-term solutions, but it became more medium to long-term in approach since 1986 when it was evident that the problems of the eocnomy were more fundamental than was previously conceived. Despite the fact that foreign exchange management since 1986 has responded adequately to the needs of the economy, it has raised several issues which the design of future national development strategies must take into account.

In the context of efforts to improve the efficiency of foreign exchange management in Nigeria, the aim of this paper is to review and assess the foreign exchange management strategies under the on-going Structural Adjustment Programme (SAP). Part I of the paper provides a conceptual framework for the subsequent analysis. Part II undertakes a brief review and appraisal of foreign exchange management between 1960 and 1985, while Part III examines the foreign exchange management strategies since the inception of SAP in 1986 up to the end of 1989. Part IV discusses the outstanding issues of foreign exchange management and their relevance to Nigeria's long-term economic growth and development. A summary and conclusion is also provided.

PART I: CONCEPTUAL BACKGROUND

For a better understanding of this paper, it is useful to define some relevant concepts and theoretical relationships in foreign exchange management.

Basic Concepts

The most basic concept is that of *foreign exchange* which may be defined as the monetary asset used for the settlement of current international transactions and for financing imbalances in a country's external payments position vis-a-vis other countries. The main sources of foreign exchange to a country include foreign currency receipts from the exports of goods and services, inflow of foreign capital such as loans and investments, as well as grants or gifts which represent unilateral transfers. Defined in this way, foreign exchange is a component of a country's *official external reserves* which may be defined as the total stock of external assets which are available to the monetary authorities of a country for the settlement of international economic transactions. Besides foreign exchange (or convertible foreign currencies) defined earlier, the other components of external reserves are the

* The author gratefully acknowledges comments from colleagues when a similar material was presented at a symposium organised by the Nigerian Economic Society at the University of Lagos on April 21,1990

** Director of Research, Central Bank of Nigeria, Lagos.

holdings of monetary gold, the reserve position in the International Monetary Fund (IMF) and the holdings of Special Drawing Rights (SDRs). For the purpose of this paper, there is a focus on the official external reserves, particularly the foreign exchange component.

Deriving from the definition of foreign exchange given above, *foreign exchange management* can be defined as the art of ensuring that the country's available foreign exchange resources meet the needs of the economy – the issue of adequacy – and that foreign exchange resources are optimally deployed. The level of dependence of a country on international trade will to a large extent determine its degree of involvement in foreign exchange management. Apart from ensuring that the value of its foreign exchange resources is secure, the country must ensure that the resources are at a level adequate to meet its current trade commitments. Consequently, foreign exchange management embraces policy actions relating to foreign exchange receipts, disbursement and building up of official reserves.

If a country must manage its foreign exchange resources well, it should be done on the basis of acceptable criteria to measure the *adequacy* of the foreign exchange resources. However, because the role of foreign exchange varies from country to country, there have not emerged generally acceptable measures of foreign exchange adequacy. In general, the adequacy of foreign exchange resources will depend on, among other factors, the motives for holding the resources as well as the rate of their inflow and disbursement. Two measures of adequacy are now commonly used by countries. At a rather theoretical level, adequacy can be related to some macro-economic variables such as the money supply, national income and trade balance. At a practical level, reserve adequacy is measured by specifying a given level of reserves that is sufficient to meet the needs of an economy over a given period of time. This is the basis of the reserves/import ratio which emphasises the transactions motive for holding reserves by specifying the minimum reserves requirement of a country that would meet her import demand over some given period of time. Conventionally, a reserve level sufficient to finance a minimum of four months' import bills at the current monthly rate of importation is considered adequate. Nigeria has used this indicator since 1962.

Policy Instruments of Foreign Exchange Management

Less-developed countries have applied many policy instruments for effective management of their foreign exchange resources. These instruments can be roughly divided into three groups - those that focus on controlling the demand and supply of foreign exchange, as well as those aimed at curbing demand while assisting in building up the supply base.

The first group of instruments which attempt to limit demand within the available supply include:

(i) trade and exchange control,
(ii) administrative control, and
(iii) foreign exchange budgeting.

Basically, a trade and exchange control regime is one which tries to eliminate a potential balance of payments deficit through the rationing of the available foreign exchange. This process could allow for improvement in the balance of payments, build-up of external reserves position and an optimal development of foreign exchange resources. To achieve these objectives, a trade and exchange control regime usually has such features as stringent restrictions on trade flows especially during periods of severe pressures on foreign exchange resources, as well as numerous regulations on the use of foreign exchange. For instance, importers and other users of foreign exchange may be required to obtain approval for the purchase of foreign exchange from a central pool, while exporters maybe required to surrender their export earnings to the same pool. In general, such a regime requires that all foreign exchange transactions must be channelled through authorised agents. The use of administrative controls and budgeting tends to supplement the goal of trade and exchange control. Administrative devices are generally used to make exchange control measures more effective through, for instance, greater scrutiny of foreign exchange applications, lengthening the process between granting approvals and actual remittance and monitoring of the utilisation of approvals with respect to their contents and values. On the other hand, foreign exchange budgeting provides an overall control whereby foreign exchange receipts and payments are matched at the beginning of a period and these form the basis of periodical evaluation of the control apparatus.

The second group of policy instruments used mainly in enhancing the supply of foreign exchange resources includes, among others, export promotion and portfolio diversification. Export promotion involves the use of incentives to boost the volumes and values of exports as a way of earning enough foreign exchange to acquire imports, ensure balance of payments viability and promote export diversification. On the other hand, portfolio diversification which refers to the investment composition of available foreign exchange resources is aimed at preserving the capital value of the external assets. The investment policy is normally directed towards holding liquid, profitable and low-risk assets in order to ensure maximum return on investment while minimising exchange risk which could be high if assets are concentrated in one currency which may be subject to depreciation or even devaluation.

The third group of policy instruments consists of macro-economic policy tools which could enhance the supply of foreign exchange while curbing the excessive use of it. Monetary and fiscal policies, while trying to reduce inflationary pressures and maintain budgetary discipline, create the necessary environment for effective foreign exchange management. Exchange rate policy which is also an important element of macroeconomic policy is critical for foreign exchange management. Since the exchange rate is the price of one currency in terms of another, it is determined by the interplay of supply and demand under a free market environment. An appropriate exchange rate will tend to maintain equilibrium in the outflow and inflow of foreign exchange in the economy. An inappropriate exchange rate policy in the form, for instance, of under and overvaluation of the currency will tend to create instability in the foreign exchange market and make foreign exchange management more difficult.

PART II FOREIGN EXCHANGE MANAGEMENT IN THE PRE-SAP PERIOD

A brief overview of foreign exchange management strategies in the pre-SAP period is necessary in order to place the current management strategies in their proper perspective. Focusing on the 1962 - 1985 period, the paper discusses the main features of the period, the objectives of foreign exchange management, and the instruments used, before attempting an overall appraisal of the strategies applied.

Background And Objectives

With respect to the features of the period, two aspects can be examined - the institutional set up for foreign exchange management and the varying economic environments which were influenced to a large extent by the prevailing foreign exchange position. The major institutional development during the period was the authority given to the Central Bank of Nigeria in 1962 to be the main custodian of the country's foreign exchange reserves which previously had been held jointly with the Federal and Regional Governments including their parastatals. From that year, the CBN held the bulk of the country's external assets leaving only working balances with the other holders. The Bank subsequently took steps to diversify the foreign reserves away from sterling assets and into other assets. Thus effective management of foreign exchange reserves could be embarked upon by the monetary authority. However, foreign exchange management was affected by, among other factors, the nation's economic and foreign exchange position. The period 1962 - 1985, as noted earlier, for the most part was characterised by inadequate foreign exchange resources a situation that was more relatively difficult to manage. The sub-periods of acute foreign exchange scarcity were 1962 - 73, 1977 - 79, and 1981 - 85. However, between 1974 and 1976 and in 1980, foreign exchange resources expanded substantially due to the favourable price development in the international oil market, with crude oil being the main source of foreign exchange earnings. In these periods, foreign exchange disbursement was rather liberal, thus increasing the pressures in periods of scarcity.

Foreign exchange management during the period had three, but not mutually exclusive objectives. These were to conserve the available resources, ensure the adequacy of reserves and preserve their value. The first objective of conservation could be realised with the concentration of foreign exchange holdings at the Central Bank and what was required was to ensure that the rate of foreign exchange expenditure was controlled to check undue depletion of reserves. The second objective of reserve adequacy was important to ensure that the foreign exchange reserves were maintained at levels consistent with current and future international commitments. The third objective arose from the second and it sought to preserve the purchasing power of the reserves through their optimal deployment into strong currencies, making it relatively easy to switch assets as the need arose and ensuring that they were easily realisable to meet payments obligations. In terms of the sub-periods discussed earlier, it can be said that ensuring the adequacy of reserves was a paramount objective in all of them, but certainly was more important in the periods of foreign exchange scarcity. In periods of scarcity also, the conservation objective was of priority, while asset preservation appeared more urgent during periods of comfortable foreign exchange resources.

Instruments of Foreign Exchange Management

During the period under review, several instruments were designed to manage the country's available foreign exchange resources, but greater reliance was put generally on the use of controls. The most important legal backing for this was the Exchange Control Act of 1962 which vested the Minister of Finance with the authority to grant approvals in respect of foreign exchange transactions. But most of the functions relating to private sector transactions were delegated to the CBN which in turn delegated approving authority for most of the transactions to the authorised dealers. The Federal Ministry of Finance dealt with applications from the public sector and some major private sector transactions. The exchange control practice was well-known for the numerous regulations on the use of foreign exchange usually under a foreign exchange budget. For instance, importers and other users of foreign exchange were required to obtain approval to purchase foreign exchange from the authorities, while exporters were required to surrender their export proceeds to the same authorities. The most important requirement was that all foreign exchange transactions were required to be channelled through the authorised dealers failing which stiff penalties were applied. Various administrative controls in addition to quantitative import restrictions were designed to back up the regulations. Some of these included the import licensing requirement, the requirement of Form 'M' and the institution of the Comprehensive Import Supervision Scheme (CISS). Generally, the control measures, were made stringent when balance of payments deficits were severe and relaxed during periods of strong balance of payments position. Stringent exchange control was prominent during 1982 - 1985 when there were severe pressures on the balance of payments. Exchange control regulations were relaxed during 1972 - 1976 and 1980 - 1981 when the balance of payments position either moved from deficit to surplus or the surplus increased.

Following the dramatic increase in foreign exchange earnings in 1973, asset diversification became very relevant as an instrument of foreign exchange management the primary aim being to preserve the capital value of the assets. Also, the prevailing instability in the international monetary system compelled the Bank to distribute its foreign exchange assets in order to reduce the risk of capital loss. To achieve the aim of asset diversification, an Investment Management Committee was established in December 1974 charged with the responsibility of investing in securities of varying degrees of maturity denominated in major international currencies. The objectives of asset diversification were generally achieved by this strategy and as at the end of 1976, the CBN's external assets were held in nine convertible currencies compared with only four at the end of 1974.

To some extent, fiscal and monetary policies were also designed during this period to influence judicious use and promote increased earnings of foreign exchange. To recount all these here is really unnecessary. But the use of exchange rate policy which is a key element in the macroeconomic framework needs some focus. During the period, the naira was not traded on the exchange markets and its exchange rate was administered or managed. Thus, with the advent of floating exchange rates in the world economy, the value of the naira was fixed in terms of the US dollar and in terms of the British Pound Sterling independently, on the basis of the relative strengths of the two convertible currencies. From February

1978 to the adoption of SAP, the naira exchange rate was based on import-weighted basket of currencies supplemented by such factors like reserve level, cross-rate considerations, relative rates of inflation and discretional judgement of the perceived relative strengths of various currencies of major trading partners. The actual determination of the naira exchange rate appeared to have been largely influenced by the levels of foreign exchanged inflow and reserves. Generally, the naira exchange rate was appreciated when the level of reserves was increased, but a corresponding policy of depreciation was not promptly applied when the reserve level declined. The monetary authorities retained a large measure of discretion in setting the naira exchange rate in spite of the laid down criterion of import-weighted basket of currencies. All these actions coupled with the expansionary fiscal policy of the government resulted in an overvalued exchange rate of the naira throughout the period.

Appraisal of Foreign Exchange Management Strategies

The foreign exchange management strategies in the pre-SAP period had two important elements which have been discussed ealier. The first was the exchange control regime used to stem foreign exchange outflow and improve the balance of payments position. There is need for evidence to indicate whether these objectives were achieved. The second was the exchange rate of the naira which gradually became overvalued. It is also necessary to examine the effect of this on foreign exchange management and the economy itself.

On the role of the exchange control regime, the important work by Anifowose (1983) was quite revealing. There were two important conclusions from his study. Firstly, it was found that during the period 1967 - 1981, strict applications of exchange control did contribute to correcting balance of payments deficits and stemming foreign exchange outflow. But in some periods when substantial balance of payments surpluses were generated, other factors, especially favourable oil prices, rather than exchange control were predominant. Secondly, although exchange control could be useful in checking foreign exchange outflow, it had its social costs in the Nigerian environment. These included malpractices and evasions, bottlenecks in the production process and corruption all of which tended to dent the image of the country. It was however observed that these malpractices prevailed even when exchange control regulations were somewhat relaxed, suggesting that only total elimination of the controls could have stopped the malpractices and attendant social and economic costs.

Nigeria's exchange rate policy which encouraged overvaluation of the exchange rate during the period was counterproductive to effective foreign exchange management. Firstly, it undermined the incentives to produce for export because of the resultant uncompetitive prices in local currency. This was one basic reason for the collapse of Nigeria's traditional exports. Secondly, the overvaluation made imports cheaper which explained the high rate of importation of consumer goods into Nigeria. This factor created excessive demand for limited foreign exchange resources and contributed in no small way to the growth of fraudulent activities in the import trade. Thirdly, the naira overvaluation helped to sustain the manufacturing sector's overdependence on imported inputs which were made cheaper. In addition to this, such industries were protected by high tariffs on competing imports of final goods. Fourthly, the overvalued naira exchange rate encouraged the growth of parallel foreign exchange markets and capital flight. Owing to the scarcity of and rationing of available foreign exchange, the so-called "black" markets (parallel markets) emerged in many obscure and sometimes open places where foreign exchange dealings took place surreptitiously. The parallel markets generally tried to meet the unsatisfied demand from the official sources. With the inappropriate exchange rate, private suppliers preferred to sell their foreign exchange holdings in the parallel markets. Invariably, official foreign exchange found its way into such markets. These leakages were detrimental to the foreign exchange management process. On the other hand, the naira overvaluation generated a lot of speculations regarding possible changes in policy. With such overvaluation, it was thought that devaluation would be applied which encouraged the transfer of funds to prevent the anticipated capital loss.

PART III FOREIGN EXCHANGE MANAGEMENT UNDER SAP

By the end of 1985 there was considerable disenchantment both in the government and private sector with the use of wide ranging controls as a tool of economic management, particularly when the renewed wave of controls between 1982 and 1985 failed to stem the deterriorating external payments problems of the period. This was evident in the formulation of the 1986 Budget and economic policy proposals, which amounted to a clear departure from previous policy strategies. While it was accepted that the control measures did to some extent assist in reducing excessive foreign exchange expenditure, their cost to the economy was considered enormous. Consequently, the 1986 Budget sought to de- emphasise controls and adopted policy measures aimed at expanding the economy's resource base. To attain this goal, the 1986 Budget contained three important policy measures. The first set of measures was contained in the Export (Incentives and Miscellaneous Provisions) Decree of 1986 whose main aim was the enhancement of the country's level of foreign exchange earnings from non-oil sources which would also greatly reduce the dependence on the oil sector as the major source of foreign exchange. Under the Decree, there was among others, a currency retention scheme under which exporters of non-oil commodities were permitted to retain 25 per cent (later increased to 100 per cent under SAP) of their export proceeds as an incentive to produce more for export. The second was the initiation of the Domiciliary Account scheme which permitted individuals and corporate bodies resident in Nigeria to operate foreign currency accounts with banks in Nigeria. The main objectives of the measures were to check the outflow of foreign exchange by residents and reduce the demand pressure on official foreign exchange resources. Lastly, the Budget hoped to establish the Second-Tier Foreign Exchange Market (SFEM) later in the year as a means of achieving a more rational determination of the naira exchange rate and consequently a more efficient allocation of foreign exchange resources.

Economic deregulation in contrast to economic control was the philosophy behind SAP which attempted to build on the 1986 Budget. Adopted in July 1986, SAP's main element was the adoption of appropriate pricing policies in all sectors of the economy with greater reliance on market forces and reduction in complex administrative controls with a view to rationalising the use of scarce resources, promoting economic diversification and stimulating domestic production.

Objectives of Foreign Exchange Management

Basically, under SAP, foreign exchange management hinged on providing a mechanism for achieving a realistic exchange rate of the naira. Since the naira exchange rate was grossly overvalued, such a mechanism would be expected to result in a depreciated naira exchange rate which would in turn lead to the attainment of several desirable objectives. On the demand side, such a realistic rate should reduce excessive demand for foreign exchange, particualrly for the importation of finished goods and services. On the supply side, the realistic rate should eliminate the prevailing distortions in the economy and stimulate non-oil exports in particular as well as attract inflow of foreign capital and funds held abroad by Nigerians. Effective rationalisation of the demand and supply of foreign exchange would ultimately produce a salutary effect on the country's balance of payments position. If the objective of eliminating bureaucratic and rigid exchange controls could be attained, it was also feasible for the new foreign exchange system to eliminate illegal currency trafficking, smuggling activities and other foreign exchange malpractices. Ultimately, these developments should result in a large degree of convertibility of the naira under which the benefits of trade expansion, larger investment inflow, efficient resource allocation and the absence of currency malpractices can be sustained.

The SFEM was the main institution at the inception of SAP for the achievement of the foreign exchange management policy objectives. The first-tier market also operated alongside the SFEM operations and was designed to accommodate payments for public sector debt service payments and obligations to international organisations and embassies. However, in July 1987, the market determination of the naira exchange rate was reinforced when a single FEM emerged from the merger of the first-tier and SFEM exchange rates. The FEM covered not only dealings in official funds, but also autonomous funds which encouraged exporters because of a much depreciated rate to repatriate their proceeds. The operations of the autonomous segment of FEM later became destabilising arising from the tendency towards high arbitrage premium and suspicion that official fund was finding its way into the segment and had to be merged with the official segment early in 1989.

There were other institutional adjustments to support the effectiveness of the management system. The Commodity Boards which had hitherto the sole responsibility of marketing non-oil exports were dissolved in December 1986, thereby enabling individual producers to handle the marketing of their products. Also, with the abolition of import and export licensing, the Federal Ministry of Trade ceased to be part of the foreign exchange management process. Late in 1989, the bureau de change was introduced into the foreign exchange market to handle small scale foreign exchange transactions based on non-official funds which could further reduce demand pressure on official foreign exchange resources and also reduce illegal foreign exchange practices.

Policy Instruments For Foreign Exchange Management

A number of policy instruments were adopted at the inception of SAP and in the process of programme implementation to attain the objectives outlined above. One of the incentives for boosting export receipts and diversifying the export base was the abolition of the commodity boards and the export licensing requirements which was done to encourage more people to export. However, companies which fail to repatriate export proceeds as required are penalized through curtailment of their use of other foreign exchange facilities. Another incentive was the permit given to exporters to retain 100 per cent of their export proceeds in their domiciliary accounts as a way of checking over- invoicing of and incidence of capital flight and smuggling activities. Some institutional facilities were introduced to support the export drive. One of these was the implementation of the new shipping policy under the aegis of the newly established National Martime Authority based on a 40-40-20 formula allowing Nigerian vessels to lift 40 per cent of the value of trade while trading partners' and third party vessels could lift 40 and 20 per cent respectively. This measure has a great potential for enhancing Nigeria's foreign exchange earnings from the maritime trade. Other export facilities include those introduced by the CBN such as the Rediscount and Refinancing Facility (RRF) and the establishment of the Nigerian Export Credit Guarantee and Insurance Corporation (NEXIM). The CBN facility was introduced to induce authorised dealers to go into export financing. Loans given to exporters by the dealers can be refinanced by the CBN at its minimum rediscount rate, which would provide a good margin to the dealers who lend at commercial rates. The NEXIM was established to give further incentives to exporters through credit, loan guarantee and insurance.

To keep foreign expenditure within reasonable limits, some instruments were designed and backed up by appropriate measures. The instruments include the operation of strict foreign exchange budget control, pegging of debt service payments and evolving a viable exchange rate of the naira. Of course, monetary and fiscal policies have been used to support these measures from time to time.

Appraisal of Foreign Exchange Management Strategies

In evaluating the effectiveness of the foreign exchange management strategies adopted since 1986, we intend to identify the achievements of the new system, as well as the outstanding problems. The achievements of the new foreign exchange management strategies should be based on objective criteria, derived from the underlying objectives of the programme. In this connection, five aspects may be examined; deriving a viable exchange rate for the naira, expanding and diversifying non-oil exports, reducing non-essential importation, strengthening the balance of payments position and eliminating illegal foreign exchange practices. Available data on these aspects are presented in Tables 1 - 7.

That the naira exchange rate has to a large extent shed its overvaluation since SAP is hardly controvertible. The bone of contention has been whether it has at each point in time attained a reasonable degree of viability or whether the rate so established has engendered economic stability. While many believe that the rate has moved reasonably to its equilibrium level, others have argued that the naira has become undervalued. Since a free exchange rate system should be driven by the everchanging national and international economic environment, it will only be valid to argue for a particular exchange rate level after identifying all the relevant determinants. In this vein, it appears that instability of the rate rather than undervaluation has been the main problem of the naira exchange rate since SAP and this is discussed under the outstanding problems later. Generally the more appropriate Naira exchange rate established since 1986 has produced some favourable effects on various micro and macro variables. For instance, the value of non-oil exports averaged N2.7 billion between 1987 and 1989, which was nearly six times the average between 1984 and 1986. The upward trend observed since 1986 was sustained up to 1989. While the value of imports has increased substantially due to the depreciated naira exchange rate, the growth in dollar terms has been much less than during the pre-SAP period. On the other hand, the structure of imports has shifted slightly towards capital goods and raw materials and away from consumer goods. The proportion of the latter out of total imports has declined from about 30 per cent during the three years preceding SAP to 25 per cent between 1987 and 1989. Under FEM, the bulk of foreign exchange has been allocated to the directly productive sectors such as industry and agriculture.

Overall balance of payments position has gradually improved since SAP with a consequent positive effect on foreign exchange reserves. Of special significance was the large increase in official reserves from N3.3 billion in 1988 to N13.8 billion in 1989. At that level, the reserves could cover 3.8 months of foreign exchange commitments at the prevailing average rate of disbursement, compared with 1.3 months at the end of 1988. On the objective of reducing foreign exchange malpractices, it can be claimed that the new foreign exchange malpractices, it can be claimed that the new foreign exchange system hs reduced the level of such malpractices. The activities of the parallel market have continued since the official market could not meet all the demand for foreign exchange. Further liberalisation of the system through the creation of the bureau de change referred to earlier has however reduced the overall importance of the parallel market in foreign exchange transactions.

While the foreign exchange management strategies since 1986 have brought some economic benefits, some problems have emerged and in most cases reflect symptoms of the economy's fundamental problems. Although, it is clear that the naira exchange rate has moved towards a more appropriate level since SAP, the instability of the market rates has been of concern to the authorities. For instance, the naira exchange rate deprecaited by 20 per cent at the end of 1987 compared with the level at the end of 1986. By December 1988, the rate depreciated further by 22.7 per cent, while it depreciated by another 30 per cent at the end of 1989. The major effects have been increased cost-push inflation, speculation and its unconduciveness to planning. Frequent institutional adjustments have added to the instability since the authorities all along wanted to achieve the objective of enhanced private foreign exchange earnings in view of the instability of the official component. Another major cause of instability has been the inadequate funding of the market. Demand has continued to exceed supply of foreign exchange because virtually every unit of the higher total liquidity of the system is a potential buyer of the grossly diminished foreign exchange earnings. For instance, while the weekly supply of foreign exchange rose from US $42.5 million in 1987 to US$55.0 million in 1988, it declined to US$46.1 million in 1989. On the other hand, the weekly demand for foreign exchange rose from US$53.6 million in 1987 to US$62.7 million in 1987 and US $333.4 million in 1989. As a result, the supply gap declined from $11.1 million per week in 1987 to US $7.7 million in 1988, but increased sharply to $287 .3 million in 1989. These trends not only resulted in large fluctuations in the naira, exchange rate, but in its persistent depreciation against the US dollar.

Domestic inflation rates have risen faster than those of our trading partners and certainly the inflation rates of 1988 and 1989 were rather excessive. This has been another source of exchange rate instability. It should however be remembered that there have been other causes of high inflation besides the cost- push effect of the depreciated naira exchange rate. Expansionary monetary and fiscal policies which have fuelled demand pressures in the midst of perennial supply bottlenecks have been important in the high dometic inflation. It is instructive to note that steps taken by the government to increase funding of the FEM through obtaining balance of payments support loans and mopping up excess liquidity from the economy since the second quarter of 1989 have helped to stabilise the naira exchange rate since then. In fact, much of the depreciation of the naira exchange rate occurred in the first two months of the year which recorded a depreciation rate of 29.4 per cent. During the one year period ending February 1990, the naira exchange rate depreciated by only 3.9 per cent. Also the parallel market premium has been reduced substantially. It increased from 9.4 per cent at the end of 1987 to 56.1 per cent at the end of 1988, but narrowed to 24.0 per cent in December 1989.

The fundamental factors of the unstable naira exchange rate and the weakness of the naira generally must be realistically traced to their sources and this leads us to examine the serious problems associated with the fragile export base and the built-in high import dependence of the economy. Export receipts have continued to be as unstable as they were in the early 1980s though the trend is currently favourable due to the better situation of the international oil market. At the same time, the prices of non-oil exports, particularly the traditional ones, have been depressed while the protectionist tendencies in the industrial countries have been inhibitive to the growth of manufactured exports. The result has been that oil still accounts for about 95 per cent of total export earnings at present. To all intents and purposes, the diversification objective is still far from being achieved. The implication is that the economy is still prone to shocks in the present situation of its export structure. Coupled with the fragile export structure, foreign exchange leakages through non- repatriation of export proceeds and smuggling activities have persisted. It is clear that no matter how liberal the system is some economic agents try to engage in malpractices which tend to undermine the institution of many incentives. With respect to the persistent high demand for foreign exchange, there are two outstanding issues. First is the economy's heavy dependence on imported raw materials, machinery and spare parts. Even if the importation of consumer goods could be reduced significantly in the short run, it is unlikely that such a result can be achieved in the case of capital goods and raw materials on which the domestic production process is heavily dependent. The second is the high debt service payment which is also in-built into the system since it is a result of past actions. Even if the economy can limit itself to the 30 per cent debt service ratio being currently applied, it is definitely too high relative to the country's foreign exchange supply and it is a far cry from the debt service ratio of about one per cent before 1980.

PART IV THE FUTURE OF FOREIGN EXCHANGE MANAGEMENT

The main feature of foreign exchange management under SAP has been the movement away from the use of controls as an instrument into the use of free market principles and private initiative in a deregulated environment. This feature is vividly illustrated in the current trade and exchange regime. However reliance on free market forces and private initiative has not been pursued as a self-justifying strategy, as official intervention has been adopted to avoid serious policy conflicts. For instance, there has been official intervention in the exchange rate determination on several occasion while transactions in the FEM are still partially based on a system of allocation rather than on full application of interplay of supply and demand forces. Also, many trade restrictions have been retained or newly imposed in the interest of the economy as a whole.

From the analysis in Parts II and III, an important factor in effective foreign exchange management is an adequate supply of foreign exchange which can only be derived from a diversified export base and stability of the foreign exchange inflow. Another critical factor is the ability to disburse the foreign exchange inflow in favour of the productive sectors that are expected to guarantee future foreign exchange supply. On the basis of these factors, foreign exchange management even under the free market environment has faced major difficulties mentioned earlier. These include the persistently narrow export base which has largely depended on the crude oil sub-sector, the instability in export receipts due largely to low commodity prices and the large portion of foreign exchange earnings devoted to debt service payments.

The seriousness of some of these problems is only beginning to be properly understood in the country. We can illustrate with three of them - the commodity problem, increasing international protectionism and the external debt burden. Firstly, there is the problem of the long-term decline in the demand for primary commodities on which the developing countries largely depend for their export earnings. Even if Nigeria were to regain her lost position in the exports of primary products like cocoa, palm produce, grains and cereals, the prospects of poor for substantial growth in export receipts because of the excess supplies of these commodities in the world markets at present. This was the basis of the recent ban on the exports of primary commodities like cocoa beans, palm kernels and natural rubber. Apart from excess supplies which have depressed prices to their lowest levels in 60 years, exporters of primary products have to contend with the unstable growth in the industrial countries which determine the demand for these products, and the reduction in the intensity of raw materials utilization in production processes due to improved technologies. It should also be remembered that most developing countries are now implementing structural adjustment programmes which all emphasise export promotion. If they all succeed, the commodity problem will be compounded. Secondly, the increasing level of protectionism by the industrialised countries has the potential to dampen outward looking trade strategies and also has the implication that diversification into processed or manufactured exports is equally difficult to sustain in the present international environment. It is a fact that some developing countries is South East Asia and Latin America have achieved a major break through in their export promotion strategies. But the developing countries as a group appear to be having problems penetrating the markets of major industrialised countries. Very often, this has implied the control of imports from the developing countries through the imposition of tariff and non-tariff barriers such as the imposition of quotas, voluntary export restraints, licensing, embargoes and minimum price regulations. These have been done to protect local industries and provide short-run support for the balance of payments. Incidentally, the developing countries adopt similar restrictive trade actions for the same reasons, suggesting that contrary to expectations, the world economy is not opening up as fast as it should. In a world of powerful economic blocs, the developing countries are unfavourably placed in terms of increased trade flows. Thirdly, there is the issue of Nigeria's serious debt burden. By all conventional external debt indicators, her debt burden is heavy. For instance, the debt service ratio moved from an average of only 0.7 per cent between 1971 and 1977 to 8.8 per cent in 1982 and has remained under 30 per cent since 1986 because of the official policy not to allow it to exceed that level. As a matter of fact, if it were possible to effect all the debt service payments due, the debt service ratio would not be less than 40 per cent a year. AS the economy utilises more than the requisite proportion of its export receipts to service debt, there is less for supporting investment in the economy. The increased debt burden has been transmitted into a balance of payments problem partially stemmed by a relatively lower volume of importation of capital goods and raw materials which may be linked indirectly to slow growth in domestic output particularly in the agricultural and industrial sectors. These are the sectors that should strengthen the export promotion drive.

However, it is not being suggested that the current strategies, particularly those that bear on foreign exchange management are wrong. What is being suggested is that just as, with a knowledge of hindsight, a trade and production strategy based on import substituting industrialisation was not the most effective one, undue emphasis on an export-oriented growth has its limitations outlined earlier which must be constantly reviewed in the context of overall development strategies. Over time, it should be possible to develop an external trade policy strategy within the development planning process which should normally focus on rapid agricultural and industrial transformation in the economy. In other words, the role of external trade in an economy should be designed from its internal strength. A country like Nigeria with a potentially strong economic base should not be over dependent on external trade. The economy is capable of being developed into a strong one where the eventual convertibility of the naira could ensure optimum allocation of resources and short-run crisis management of foreign exchange resources would be unnecessary. The hard knot of this ultimate goal of development is that more foreign exchange is needed for supporting the economic base. The effective implementation of Nigeria's Perspective and Rolling Plans is the fastest way to get away from this dilemma.

Summary and Conclusion

This paper has assessed the foreign exchange management strategies under the Structural Adjustment Programme in Nigeria. It defined foreign exchange management as embracing policy actions relating to foreign exchange receipts, disbursement and building up of official reserves. The main instrument of foreign exchange management on the demand side is trade and exchange control which attempts to eliminate potential balance of payments deficits through the rationing of available foreign exchange. Export promotion and portfolio diversification are the main tools on the supply side, while various macroeconomic policy instruments could be used to influence both the supply and demand for foreign exchange. Under a free market environment, exchange rate policy is an important instrument in foreign exchange management.

By and large, foreign exchange management in pre-SAP Nigeria relied on the use of trade and exchange controls. The exchange rate of the naira was administered and because it tended to be overvalued, it inhibited effective foreign exchange management. The empirical evidence is that the use of these tools generally contributed to correcting balance of payments deficits but it had its costs in malpractices and evasions, as well as being a source of bottlenecks in the production process. The exchange rate regime discouraged production for export, encouraged imports especially of consumer goods and raw materials, and induced the growth of parallel foreign exchange markets with all its adverse effects.

Foreign exchange management under SAP was designed within the overall philosophy of economic deregulation and the dominance of free market forces. A mechanism for achieving a realistic exchange rate of the naira was designed to curb excessive demand for foreign exchange, while in addition to other incentives it was expected to boost export earnings. Since SAP came into force, the over-valuation of the naira exchange rate has largely been removed and this has to some extent boosted non-oil exports and checked the inflow of non-essential imports. The balance of payments position has improved while there has been satisfactory build up of external reserves. However, some problems have been experienced and these include the instability in the naira exchange rate which at various times encouraged speculation and reinforced inflationary tendencies. While the exchange rate of the naira remained stable since the second quarter of 1989, the basic problems of the situation generally persist and these include the fragile export base and foreign exchange leakages in the midst of strong demand for foreign exchange, arising from continued heavy reliance on major imported inputs and the heavy debt service burden.

These outstanding problems – the poor prospects of non-oil exports coupled with the uncertainty of oil export receipts, the increasing protectionism in the industrial countries which does not favour significant growth in the exports of manufactured goods and the heavy debt service burden would suggest that the overall role of external trade in the development of the Nigerian economy should be critically reviewed. The internal strength of the economy should be built up through agricultural and industrial transformation which, with the big potential of the Nigerian economy should result in its less dependence on external trade and short-run crisis management of limited foreign exchange resources. The achievement of this ultimate goal will depend on full commitment to the implementation of the perspective plan which has been proposed.

TABLE 1

VALUE OF NIGERIA'S MAJOR EXPORTS
(₦' Million)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[1]
TOTAL MAJOR AGRIC. COMMODITIES	340.5	178.4	92.0	259.0	208.0	192.1	407.4	1,5[illegible].5	1,794.2	1,739.1
OTHER COMMODITIES	212.8	93.2	98.5	42.3	39.4	305.0	143.4	[illegible].5	963.2	1,215.3
CRUDE PETROLEUM	13,633.4	10,680.5	8,601.6	7,201.2	8,840.6	11,223.7	8,368.4	28,208.6	28,435.4	55,016.8
GRAND TOTAL	14,186.7	10,952.1	8,792.1	7,502.5	9,088.0	11,720.8	8919.2	30,360.6	31,192.8	57,971.2
% OF TOTAL EXPORTS										
(a) Agric. Commodities	2.4	1.6	1.0	3.4	2.3	1.6	4.6	5.2	5.7	3.0
(b) Other Commodities	1.5	0.9	1.2	0.6	0.4	2.6	1.6	1.8	3.1	2.1
(c) Crude Petroleum	96.1	97.5	97.8	96.0	97.3	95.8	93.8	93.0	91.2	94.9
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[1]Estimates

SOURCE: Federal Office of Statistics

TABLE 2

IMPORTS BY MAJOR GROUPS
(N' Million)

	1981	1982	1983	1984	1985	1986	1987	1988	1989[1]
Consumer Goods	5,736.3	4,480.5	3,700.8	2,656.7	2,069.3	1,757.8	4,304.7	6,154.9	8,424.8
Durable	1,576.2	861.6	858.8	632.5	247.2	302.9	839.5	214.5	1,234.4
Non- Durable	4,160.1	3,618.9	2,842.0	2,042.0	1,822.1	1,454.9	3,465.2	5,940.4	7,190.4
Capital Goods	4,018.0	3,532.7	2,886.3	2,307.2	2,486.0	2,422.9	7,568.0	6,862.6	13,794.5
Raw Materials	3,152.4	2,703.4	2,307.7	2,133.3	2,493.1	1,751.9	5,983.7	8,406.8	8,600.7
Miscellaneous	12.9	53.9	8.9	81.1	14.2	6.0	5.3	21.4	9.3
TOTAL	12,919.6	10,770.5	8,903.7	7,178.3	7,062.6	5,938.6	17,861.7	21,445.7	30,860.2

[1]Provisional

SOURCE: Federal Office of Statistics, Lagos

TABLE 3

FOREIGN EXCHANGE FLOWS THROUGH THE ECONOMY
(N' Million)

	1981	1982	1983	1984	1985	1986	1987	1988	1989[1]
INFLOW	12,972.8	10,064.1	8,449.7	9,263.6	11,024.1	12,496.1	26,374.8	29,133.4	58,146.8
Oil	10,567.0	8,197.7	7,374.1	8,418.9	10,180.9	8,293.0	18,637.2	22,162.0	43,551.9
Non- oil	2,405.8	1,866.4	1,075.6	844.7	843.2	4,203.1	7,737.6	6,971.4	14,594.9
OUTFLOW	15,993.6	11,462.4	8,751.0	8,908.6	10,463.0	9,752.7	21,251.3	28,376.1	47,500.4
(a) Visible	13,379.4	9,588.9	5,601.2	5,204.8	5,032.5	5,667.1	11,930.0	13,910.9	19,212.1
(b) Invisible	2,614.2	1,873.5	3,149.8	3,703.8	5,430.5	4,085.6	9,321.3	14,465.2	28,288.3
(i) Debt Service	518.5	775.2	1,335.2	2,640.5	3,717.8	2,502.2	3,820.4	8,816.8	14,997.8
(ii) Others	2,095.7	1,098.3	1,814.6	1,063.3	1,712.7	1,583.4	5,500.9	5,648.4	13,290.5
(c) Autonomous	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	*	*	*
NET FLOW	-3,020.8	-1,578.3	- 301.3	+355.0	+561.1	+2,743.4	+1,123.5	+757.3	+10,646.4

N.A. = Not Available

[1]Provisional

*Added to individual items of disbursement

SOURCE: Central Bank of Nigeria, Returns of Foreign Operations Department

TABLE 4

BALANCE OF PAYMENTS SUMMARY STATEMENT
(N' Million)

	1981	1982	1983	1984	1985	1986	1987	1988	1989
Current Account	-3,998.4	-3,105.7	-820.0	1,504.2	2,215.4	-2,999.1	- 295.3	-1,437.7	13,968.4
Merchandise	- 703.5	133.8	1,508.8	3,839.9	5,065.1	3,443.9	13,968.1	11,435.0	29,729.9
Export (F.O.B)	11,023.3	9,223.9	7,751.8	9,138.9	11,720.8	8,920.5	30,360.6	31,192.8	57,971.2
Import (F.O.B)	-11,726.8	-9,090.1	-6,243.0	-5,299.0	-6,655.7	-5,476.6	- 16,392.5	-19,757.8	-28,241.3
Services & Income (Net)	-2,948.4	-2,950.1	-2,043.0	-2,081.9	-2,617.7	- 6,202.6	-14,167.2	-12,818.6	-16,440.1
Unrequited Transfers (Net)	-346.5	-289.4	-285.8	-253.8	-232.0	- 240.4	-96.2	-54.1	-678.1
Long-Term Capital (Net)	833.1	1,026.8	1,373.8	268.7	-435.1	- 3,191.0	-7,473.6	-11,427.7	-2,272.0
Direct Investment (Net)	334.7	290.0	264.3	144.5	434.1	735.8	2,452.8	1,718.2	13,983.3
Portfolio Investment	-	-	-	207.3	783.0	151.6	4353.1	2,611.8	- 1,618.8
Other Long Term Capital (Net)	498.4	736.8	1109.5	-83.1	-1652.2	- 4078.4	-14279.5	-15757.7	-14636.5
Basic Balance	-3,165.3	-2,078.9	553.8	1,772.9	1,780.3	-6,190.1	- 7,768.9	-12,865.4	11,696.4
Other Capital (Short-Term) Net	170.0	204.6	-1,102.8	-1,391.4	- 1,336.9	6,206.7	9,154.3	11,481.3	-3,796.6
Balance on Current & Capital Accounts	-2,995.3	-1,874.3	- 549.0	381.5	443.4	16.6	1,385.4	-1384.1	7,899.8
Balancing Item	-25.5	476.0	247.7	-26.7	-94.3	-800.9	-1,226.2	- 910.0	+828.0
Overall Balance	-3,020.8	-1,398.3	-301.3	+354.8	+349.1	- 784.3	159.2	-2294.1	8,727.8
Reserve Movement	+3,020.8	+1,393.3	+301.3	-354.8	- 349.1	+784.3	−159.2	+2,294.1	-8,727.8

SOURCE: Central Bank of Nigeria, Annual Report and Statement of Accounts (1981—1988)

TABLE 5

TOTAL EXTERNAL ASSETS HOLDINGS 1980 - 1989
(N' Million)

HOLDER	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
A. OFFICIAL (i + ii)	5,485.9	2,441.6	1,043.3	742.0	1,096.8	1,657.9	3,604.2	4,660.1	3,289.5	13,473.9
(i) Central Bank*	5,469.1	2,424.8	1,026.5	725.2	1,080.0	1,641.1	3,587.4	4,643.3	3,272.7	13,457.1
(ii) Fed. Government	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8
B. SEMI-OFFICIAL INSTITUTIONS WITH STATE GOVERNMENTS	7.3	6.6	6.6	5.7	5.8	5.7	5.7	5.7	4.7	4.7
C. COMMERCIAL BANKS (NET)	161.8	128.2	15.4	81.0	319.5	153.2	1412.7	3302.6	6977.5	9838.8
TOTAL	5,655.0	2,576.4	1,065.3	828.7	1,422.1	1,816.8	5,022.6	7,968.4	10,271.7	23,317.4

*EXCLUDES ATTACHED ASSETS

SOURCE: As for Table 4

TABLE 6

FOREIGN EXCHANGE BUDGET, EXPENDITURE AND EARNINGS
1980 – 1989
(N' Million)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
A. FOREIGN EXCHANGE BUDGET	7,986.0	12,500.0	9,600.0	7,200.0	8,000.0	8,500.0	9,582.0	19,896.0	33,318.0	49,192.2
B. ACTUAL EXPENDITURE OUTFLOW	11,804.8	15,993.6	11,993.6	8,751.0	8,408.8	10,463.0	5,238.9	21,251.3	28,376.1	47,500.4
C. FOREIGN EXCHANGE EARNINGS	14,207.2	12,972.8	10,042.9	8,449.7	9,263.6	11,024.1	10,238.9	26,374.8	29,133.4	58,146.8

SOURCE: CBN ANNUAL REPORT (VARIOUS EDITIONS)

TABLE 7

NAIRA EXCHANGE RATE (END OF PERIOD)
(Naira per US Dollar)

	FEM	AUTONO-MOUS	PARALLEL	BUREAU DE CHANGE
December 1986	3.3166	—	—	—
December 1987	4.1413	4.6928	4.6000	—
January 1988	4.1740	4.3611	4.8560	—
February	4.2611	4.2850	4.5000	—
March	4.3152	4.3470	4.3000	—
April	4.2525	5.8900	4.3000	—
May	4.1838	6.4943	5.4000	—
June	4.0574	6.6660	5.9000	—
July	4.3941	6.3328	6.3500	—
August	4.6440	6.8800	6.6000	—
September	4.6961	5.8115	7.2000	—
October	4.7748	6.0362	7.3250	—
November	5.1479	6.4761	7.5000	—
December	5.3530	8.2856	8.3500	—
January 1989	7.0389	—	8.8500	—
February	7.3828	—	10.5000	—
March	7.5871	—	11.6200	—
April	7.5808	—	11.4300	—
May	7.5051	—	11.3800	—
June	7.3477	—	11.5500	—
July	7.1388	—	10.5500	—
August	7.3000	—	10.2000	10.2000
September	7.3725	—	10.6000	10.7000
October	7.4750	—	10.3500	10.4000
November	7.5454	—	9.2000	9.1000
December	7.6500	—	9.6000	9.5000

SOURCE: Central Bank of Nigeria

REFEENCES

ANIFOWOSE, O.K. (1983); "The Relevance of Exchange Control in Nigeria's Balance of Payments Adjustment Process"; CBN *Economic and Financial Review*, Vol. 21, No. 3, September 1983.

COLMAN, D. and F. NIXSON (1986); Economics of change in Less Developed Countries; Phillip Allan (UK) and Barnes and Noble Books (USA)

DOWNES, P. (1989); "Managing Foreign Exchange Reserves"; *Finance and Development*, Vol. 26, No. 4, December 1989.

GRASSMAN, S. (1973); Exchange Reserves and the Financial Structure of Foreign Trade; Saxon House (UK) and Lexington Books (USA).

MAY, E. (1985): Exchange Controls and and Parallel Market Economics in Sub-Saharan Africa, Focus on Ghana; World Bank Staff working papers No 711, the World Bank, Washington DC.

NTEKOP, T.J. (1988); The Management of Foreign Exchange; the text of lecture delivered at the 23rd Annual Banking Seminar of the Nigerian Institute of Bankers, Lagos, August 4, 1988.

ODOZI, V.A. (1986); "Foreign Exchange management: The Role of the Central Bank of Nigeria" *Bullion*, Vol 10, No. 3, July/September 1986.

OJO, M.O. (1989a); "An Appraisal of the Socio-Economic Impact of Structural Adjustment Policies in Nigeria"; CBN *Economic and Financial Review* Vol. 27, No. 1, March 1989.

OJO, M.O. (1989b); "Nigeria's External Debt Problem: A Review of Management Efforts and the Prospects," CBN *Economic and Financial Review*, Vol. 27, No. 2 June 1989.

OJO, M.O. (1989c); "The Structural Adjustment Programme and Nigeria's Export Crop Sub-sector", CBN *Economic and Financial Review*, Vol. 27, No. 4, December 1989 (forthcoming).

OMORUYI, S.E. (1989); "Structural Adjustment and National Development: Deriving and Ensuring a Viable and Fair Exchange Rate for the Naira"; CBN *Economic and Financial Review*, Vol 27, No. 3, September 1989.

UMOH, P.N. (1985); "Foreign Exchange Practices in Nigeria: Historical Perspective and Implications"; *Nigerian Management Review*, June 1985.