IMPACTS OF EXCHANGE RATE MECHANISMS ON FIRST BANK OF NIGERIA PLC,

BY

U G B A N T I M O T H Y T E R Y I M A
(G978AF7079)

BEING A PROJECT SUBMITTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION AHMADU BELLO UNIVERSITY (ABU) ZARIA IN PARTIAL FULFILLMENT FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION (M.S.A.) DEGREE

OCTOBER, 1998

DECLARATION

I hereby declare that this project is written by me and that it has not been previously presented for a higher degree; that all information not original to this research have bean duly acknowledged by way of references.

UGBAN TIMOTHY TERYIMA

The above delcaration is confirmed:

HAJAI LARAI SHAFI
Project Supervisor

CERTIFICATION

This project titled impacts of Exchange Rate Mechanisms on first Bank of Nigeria PLC by Ugban Timothy Teryima meets all standards for the award of the degree of Master of Business Administration (MBA) of Ahmadu Bello University Zaria and is approved for its contribution to knowledge.

NAME AND SIGNATURE OF PROJECT SUPERVISOR

18/4/2002

NAME AND SIGNATURE OF HEAD OF DEPARTMENT

Head
Dept. of Business Admin str
Ahmadu Bello Univ rs

10/09/02

NAME AND SIGNATURE OF DEAN OF POST GRADUATE SCHOOL.

ABSTRACT

The international monetary system operated under an institutional framework known as "fix exchange rates' during the 1950s and 1960s which borke down in the early 1970s and the world economy has since then been operated under a system of "floating exchange rates', in which most major currencies have been allowed to fluctuate in response to a variety of forces, whether commercial or speculative in the international currency markets.

In Nigeria, the objective for the establishment of the Foreig Exchange Market in September, 1986 was to evolve a realistic market determined exchange rate for the naira so as to remove the naira over Valuation, reduce the pressure on the balance of payments to stop further accumulation of trade debt, reduce imports, stimulate exports and pave way for self reliant and sustainable growth.

Exchange rate mechanisms depends on a complicated interaction of factors including: inflation, the balance of payments, interest rates, Political/Strategic uncertainties, etc. However, in practical terms, what determines the external value of the domestic currency is the foreign exchange earnings and expenditures of a country. Since exchange rates are directly linked to domestric prices, the banks activities because they have effect on the monetary situation, have some bearing on exchange rate mechanisms and indeed on the broad functioning of the economy, in the sense ;es are employed and the behaviour of price levels. Thus in many respects, the frequent upheavals in the Foreign Exchange Market (FEM) is a painful but unaviodable manifestation of Governments "fight' to address the endemic vice of inflation.

Nevertheless, because the entire economy is intergrated, exchange rate Policy induced measures always turn to have some far reaching implications on the performance of commercial banks in

TABLE OF CONTENTS

PAGE

Title..... i

Declaration..... ii

Certification..... iii

Dedication..... iv

Acknowledgement..... v

Abstract..... vi

List of Tables..... viii

Table of Contents..... ix

CHAPTER ONE

1.0 Introduction..... 1 - 2

1.1 Statement of the Problem..... 2 - 3

1.2 Purpose of the Study..... 3 - 4

1.3 Hypothesis..... 4

1.4 Significance of the Study..... 4 - 5

1.5 Scope of the study..... 5

1.6 Limitations of the study..... 5 - 6

1.7 Research Sources and Data collection..... 6 - 7

1.8 Operational definations..... 7 - 10

1.9 Structure of the work..... 10

CHAPTER TWO

REVIEW OF RELATED LITERATURE AND CONCEPTUAL FRAMEWORK

2.0 Introduction..... 11

2A.1 Review of related literature..... 12 - 17

2B.0 Conceptual Framework..... 17 - 20

2B.1 The evolving structure of the Nigerian Financial sector..... 20 - 23

2B.2 The role of commercial Banks in exchange rate determination..... 23 - 27

2B.3 Determination of exhange rate..... 27 - 31

KASHIM IBRAHIM LIBRARY

2B.4.0 Exchange rate administration under the structural Adjustment programe (SAP)..... 31 - 33
2B.4.1 Exchange rate liberalization under the foreign Exchange market (FEM)..... 33 - 35
2B.4.2 Bureaux de change..... 35 - 36
2B.4.3 The Black/Parallel Market..... 36 - 37
2B.5 Causes of persistent depreciation of the naira exchange rate..... 37 - 40
2B.6 Impacts of Exchange rate mechanisms on commercial Banks..... 40 - 44
2B.7 Recent trends in exchange rate mechanisms on commercial Banks
2B.7.1 Fluctuating exchange rates and I.M.F..... 44 - 45
2B.7.2 Adjustable peg (AP) and crawling Peg (CP) exchange rate systems..... 45 - 46
2B.7.3 New exchange arrangements..... 46 - 47
2B.7.4 Arbitrage..... 47 - 48
2B.7.5 Sepeculation..... 48

CHAPTER THREE

HISTORY OF THE CASE STUDY

3.1 Introduction..... 49
3.2 Historical trends in First Bank of Nigeria PLC... 49 - 53
3.3 Organisational structure..... 53 - 54
3.4 Some major problems of First Bank of Nigeria PLC..54 - 56

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction..... 57
4.2.1 Presentation and analysis of data..... 57 - 60
4.2.2 Impacts of exchange rate mechanisms on FBN PLC. 61 - 65
4.3.1 Findings..... 65 - 67
4.3.2 Proof of Hypothesis..... 67 - 70

CHAPTER FIVE

SUMMARY, RECOMMENDATIONS AND CONCLUSIONS

5.1 Summary..... 71 - 73

5.2 Recommendations..... 73 - 75

5.3 Conclusions..... 75 - 76

Bibliography..... 77 - 79

Appendix I

Appendix II

LIST OF TABLES

TABLES PAGE

1. Gains from devaluation of the naira.....61
2. Parallel market rates as reference rates.....61
3. Liberalization of exchange rates.....62
4. Why liberalization did not lead to efficient functioning of FEM.....62
5. Relationship between exchange rate and developments in the non-oil sector.....63
6. Effects of liquidity mop-ups on FBN PLC.....64
7. The challenge of Bureaux-de-change on FBN earnings...65
8. Immediate consequences of changes in forex allocation systems and Proceedures.....66
9. Determining factors of exchange rates in Nigeria since 1986.....67
10. Implications for adoption the dual exchange rate system on FBN PLC in 1995.....68

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

Exchange rate mechanisms have recieved much attention international finance and in monetary economies in general bec of the crucial role which exchange rate as a price play in development of the national economy and in ensuring the stabi of our financial system and the economy in general. This because exchange rate links the general price level in the dome economy with that of other countries, thereby providing informat about what to produce and what to ensure among countries that t together. Against this backdrop, it may serve as an effici allocation instrument, through the adoptation of appropriate ma economic policies that ensure fiscal discipline and avoid excess monetary expansion. Consequently, both exchange rate policy monetary policy have a common objective, ie., the optionality domestic currency vis-a-vis others on the other hand. However, challenge of maintaining a stable exchange rate for Niger currency has been ardous especially with the uneasy trade- involved. The situation has been worsened by institutio weaknesses in the financial system, the volitality of the exte sector coupled with perenial and relatively high level of fi indicipline.

Exchange rate is the price at which a country's curr exchanges for other currencies in the international exch system. Exchange rate has therefore served as a major tool pursuing reserve management objectives through the preservatio the value of the external reserve assets. A stable exchange regime reflects a very strong domestic economic fundamentals w could result in the stregthening of the value of the dome currency against the foreign currencies in which the reserves kept. The exchange rate of a country may be fixed, managed allowed to float in which case the rate will be determined by

interplay of market forces notably the demand for and supply of the currency in the foreign exchange market. By implication, what determines the external value of the domestic currency is the foreign exchange earnings and expenditures of a country.

For purpose of evaluation, a successful exchange rate policy instrument must provide sufficient incentive to export of primary and secondary products and the production of local substitutes for imports. On the other hand, it must provide sufficient disincentive to imports and capital flight.

Where for any obvious reason a currency depreciates very highly due to inappropriate policies, the prices of imports and exports will change. The relative prices of both traded and non-traded goods will also change, unleasing a series of repercaussion to welfare of the citizenry. In the same vein, it may also lead to foreign exchange speculation that may worsen balance of payment problems. Under this condition, both exporters and importers are not able to make sound estimates of appropriate prices for their products. Investors, lenders and borrowers are therefore subject to exchange rate risk.

These and other considerations have influenced exchange rate machanisms in Nigeria since independence (1960). The adoption of any exchange rate regime has been made with due regard to Nigeria's domestic and external economic circumstances at each given planning time horizon.

1.1 STATEMENT OF THE PROBLEM

Exchange rate mechanisms are generally aimed at harnessing foreign exchange resources, deploying same to service the economy and to meet other international commitments while saving some to raise the level of international reserves needed to finance temporary difficulties and to safeguard the internal value of the domestic currency. But countrary to this expectations, the attainment of a "realistic" exchange rate for our domestic currency have proved difficult. Consequently, investors, lenders, borrowe

and the entire public have been exposed to exchange rate risk to an alarming scale. Hence, the naira exchange rate is no longer a "reliable" tool for policy formulation and execution.

Also as a result of sectoral imbalances in the external sector, foreign exchange inadequancy, persistent depreciation of the domestic currency and the attendant inflationary presures on the economy, a lot of policy fine-turning or overhauling is needed both on the side of governments and in respect to international financing and or financial intermediation in general. Hence, there is need to conduct a research in order to contribute in finding solutions to these teaming problems.

The researcher is therefore optimistic that the above problems could be solved if the findings contained herewith are carefully examined and the recommendations "religiously" aligned to fit specific policy objectives of governments, investors and financial intermediaries in particular.

1.2 PURPOSE OF THE STUDY

The aim of this study is to review Nigera's major exchange rate policies since independence with a view to analysing the impacts of such policies on commercial banks in Nigeria, particulary First Bank of Nigeria PLC. The researcher also seek to probe into the rationale behind such policies/policy regimes especially as they continually change in the recent past (ie. from 1986 till date).

Another objective of the study is to contribute towards finding [illegible] over [illegible] exchange rate associated problems especially in respect to the high volitality of the naira exchange rate since the introduction of the Structual Adjustment Programme (SAP) in 1986.

The study is also considered to be a good opportunity for the researcher to utilise and unfold more facts about the subject mater.

It is the expection that in the end, this study shall broaden

the researchers knowledge within the scope under consideration o the one hand, and serve as a reference material for others on t other hand.

Finally, the study would serve as a platform for t researcher's development in this area of study in particular and Banking in general.

1.3 HYPOTHESIS.

This study aims at testing the following hypothesis;

i. Exchange rate under a 'libralised' system is more economical feasible and is key to ensuring a "realistic" naira exchar rate.

ii. Where a currency depreciate, investors, lenders and borrowe are subject to exchange rate risk.

iii. Devaluation of the naira exchange rate would provi sufficient in centive to export and sufficient disincentive imports and capital flight.

iv. There is a direct relationship between exchange r machanisms and the development of the non-oil sector.

The above assumptions form the basis on which the resea would be conducted using an appropriate methodology. The resea findings would be used to prove these hypothesis later in chap four.

1.4 SIGNIFICANCE OF THE STUDY

This study is very useful especially to those interested international financial network/mechanism and the entire glc business environment comprising of investors (ie actual potential), importers, exporters, multinationals, merchant ba commercial banks, monetary authorities, etc, for analys evaluation and formulation of policy.

Also, this study is very useful because exchange r determines the relative prices of both traded and non-trad goods and services-hence the need to understand the mechanisms t could gurantee a realistic exchange rate that may in-turn ushe

a stable system reflecting all facts of the economy.

For the commical Banks in particular and the banking industry in general, this study is useful because as authorised dealers in the Foreign Exchange market (FEM), now Authonomous Foreign Exchange Market (AFEM), they stand to benefit from the revenue or proceeds accruing from playing intermediatory role in foreign exchange transactions. An under standing of the exchange rate mechanisms will expose them to how much exchange risk they should bear in their overall protfolios for what spread or returns. This would place them in a better position to decide on the level of commitment in forex transactions that will optimise returns subject to the perculiarities of each bank.

1.5 SCOPE OF THE STUDY

This study is restricted to some major policies in respect to exchange rate since 1960. However, the study pays more attention to exchange rate mechanism since September, 1986 and the impacts on commercial banks in general and First Bank of Nigeria Plc in particular.

1.6 LIMITATIONS OF THE STUDY

In the process of undertaking this research many problem abound. While some were overcomed by events, others remained unsolved. In the first instance, because most vital information required for this study were classified "secret" in some quatters, the researcher hardly had access to them.

There is also lack of "ready made" literature about the subject matter which hindered the smoothness in terms of speed and cohesion in the gathering of facts pertinent to this research.

Other difficulties encountered in the course of the research include among others; transportation problems, in-accessibility of respondents to interviews, and lack of requisite attention needed from the management staff and some employees of First Bank of Nigeria Plc.

However, despite all these teaming problems, the research was

successfully carried out and all necessary data was obtained, analysed and recommendations prescribed.

1.7 RESEARCH SOURCES AND DATA COLLECTION

The methodology adopted for this study ranges from historical to experimental survey of selected cases and observations. This method is chosen by the researcher because of its utility in describing the evolving situational trends to date while providing concrete information regarding the subject matter. Apart from documentary sources that provided the chief sources of information, other instruments were also used in the study to assist the researcher in the collection of data relevant to the study. They include interview and questionnaire.

The primary data is obtained from the questionnaire administered to 100 management staff of First Bank of Nigeria Plc. The questionnaire which was delivered directly to the respondents was closed-ended (see Appendix A). It was so designed to avoid situations were either the researcher may misinterpret wrong responses or the respondent may give wrong and irrelevant answers to questions. The close-ended questions were standardised, thus providing a greater uniformity of responses and an easy platform for processing analysing data. Infact, it made clear the dimension along which responses were sought.

An interview schedule was also conducted covering the sample size for the study. There was both face to face interactions and telephone conversations with 100 management staff of First Bank of Nigeria Plc. The questionnaire was used to conduct the interview. Although the questionnaire was closed-ended and the interview schedule structured in nature, validity of responses was ascertained by further in-depth probing on responses and by in-analysing respondents state of nervousness, hesitation, etc, in responding.

The simple Random Sampling method was employed for the sample selection. The justification for this sample selection method was

to minimise elements of biasness in the sample and ensure statistical soundness, especially as the method promise the possibility to calculate the standard error of the mean.

The researcher used the percentage system as the statistical technique for analysing the data collected from respondents. Analysis is derived from the sum percentage response of the respondents with identical answers to each question where upon a position is established based on such analysis.

Generally speaking, the techniques employed in this research were against the backdrop of certain considerations, namely, financial resources as well as the time frame required for the completion of the study.

1.8 OPERATIONAL DEFINATIONS

(i) EXCHANGE RATE

Exchange rate is defined as the domestic price of foreign money, ie, the units of the domestic currency that will purchase a unit of a foreign currency. One of the immediate consequencies of the role of exchange rate as a price is that it links together the general price level in the domestic economy with that of other countries, thereby providing information on what to produce and what to consume among countries that trade together.

In a free world economy, the rate of exchange of one currency interms of others cannot be fixed but varies continously with variations in the existing relationship between the world demand for, and supply of that currency.

(ii) FOREIGN EXCHANGE

Foreign exchange is a means of effecting payments for international transactions. It can be acquired by a country through; the export of goods and services, direct investment inflow, draw down on external loans, aids and grants etc, and it can be expended to settle international obligations, to finance shortfalls in foreign exchange receipts and to safeguard the international value of the domestic currency.

By defination, foreign exchange is the means and methods by which rights to wealth expressed interms of currency of one country are converted into rights to wealth interms of another currency. The terms cover the methods by which the currency of one country is exchanged for that of another, the causes which render such exchanges necessary, the forms in which such exchange are conducted and the ratios or equivalent values at which they are effected.

(iii) MONEY AND CURRENCY

Money is something which is accepted generally by a community as a measure of value and a medium for the exchange of goods and services.

The term "money" in the modern sense has a narrow meaning than the term "currency". The term "money" is now used to describe actual money inform of coin or notes or in any other form which passes freely from hand to hand as a recognised medium of exchange within a country. On the other hand, "currency" is a generic term and covers not only the actual coins and paper money in use in a country but also any credit instruments which convey the right to wealth in terms of any given unit, such as a cheque, a promisory note, a bill of exchange or any other instrument capable of transfering the property in the stated number of the units of account which are in use in any given country.

(iv) COMMERCIAL BANK

The traditional legal defination of bank is that it is a company which carries on the business of receiveing money from customers on deposit, lending them money, paying money on account of cheques drawn by the customers on his banker, and collecting bills, cheques and similar documents handed in by the customer for the credit of his account.

(v) DEVALUATION

Where for any reason, such as external over-valuation, it is considered necessary to cheapen the exchange value of a currency in terms of others by giving it a lower exchange value, the process is

known as "devaluation".

If a currency is on a gold standard, devaluation is effected by raising the price of gold in terms of the currency concerned, and this automatically decreases the number of units of other gold standard currencies required to purchase a given number of units of the first currency.

(vi) EQUILIBRIUM EXCHANGE RATE

The normal equilibrum rate of exchange between two convertible currencies is determined by the ratio of their purchasing powers or when the demand for and supply of currency is equal.

(vii) GOLD STANDARD

A nation is said to be fully on gold standard if the government of that country buys and sells gold in unlimited quantity at an officially fixed prices and permits unrestricted gold flows into and out of the country. The market rate of exchange between the money units of two gold standard countries is anchored to the mint parity and the factors underlying the balance of payment adjust themselves to the mint parity exchange rate.

(viii) INFLATION

There exist inflation of the currency in a country when there is too much money chasing few goods. Since the untility of money lies only in its ability to act as a medium of exchange and a purchasing agent, a country is under the same economic necessity of a firm or individual endeavouring to make its income balance its expenditure. "Deficit financing" for example is inflationary as regards the internal currency and the credit system because it places in the hands of the community more purchasing power than it draws from them inform of taxation.

(ix) STRUCTURAL ADJUSTMENT PROGRAMME (SAP)

Structural Adjustment programme (SAP) is a belt-tightenning measure adopted by the Federal Military Government since September, 1986 to put Nigeria back to the path of economic sanity and recovery. It is a call to re-order our priorities to save the

country from a downward trend and set it on a better planned economic recovery route that can stand the present time frame while looking forward for the next mellenium.

1.9 STRUCTURE OF THE WORK

The study will basically concentrate on major exchange rate policy framework since 1960 while paying more attention to impacts of such policies on commerical banks in general and First Bank of Nigeria PLC in particular. The study carefully analysis all the facts involved relating to the subject matter and drawout recommendations reflecting such analysis through inferences.

In chapter one, there is a general view of the issues at stake - ie, the research problems, the scope and limitation, the objectives and significance of the study as well as the various hypothesis raised. Operational terms are also defined to assist the layman understand the semantics as well as technical issues contained in the study. Also, sources of data collected are indicated in chapter one incase one may wish to verify or refer to for details as may be desired.

In chapter two, the main issues relating to the subject matter are cleary reviewed, while chapter three contains a brief bu important information about the case study of this research, (ie, First Bank of Nigeria PLC). Chapter four is devoted to th presentation and analysis of data whereby the findings of the study are presented.

Lastly, chapter five contains the summary, recommendations and conclusions of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE AND CONCEPTIONAL FRAMEWORK

2.0 INTRODUCTION

This chapter reviews past researches in the hope of drawing the attention of the researcher's audience to some useful informations that already exist in certain bodies, journals, articles and textbooks as well as decertations written by various authors on the subject matter. The researcher cannot pretend to have reviewed exhaustively the existing literature on the subject matter, yet, it suffice to say, that the information which is herein presented can serve as a spring-board upon which more relevant information on the subject matter may be gathered by any concerned individual or group of individuals as may be desired. The conceptual framework is therefore presented in the hope to trace the evolution and implications of certain concepts that might have been otherwise misunderstood or misrepresented in certain quatters.

In this chapter, the evolving structure of the Nigerian Financial System is well elucidated as well as the role of commercial banks in exchange rate determination in Nigeria. Various mechanisms and theories explaning how foreign exchange rates are determined (taking into account the Nigerian experience) are also reviewed. This chapter reviews also the exchange rate administration under the structural adjustment programme introduced since 1986 with emphasis on "libralization" of exchange rate in the wake of the Foreign Exchange Market (FEM) deregulation. Other aspects considered in this chapter include; Causes of persistent depreciation of the naira exchange rate; Impacts of exchange rate mechanisms on commercial banks in Nigeria and recent developments relating to exchange rate mechanisms.

2A.1 REVIEW OF RELATED LITERATURE

Theories or well known facts serve a very useful purpose for the conduct of any research. This is because such historical data

may be used to reconcile current findings in order to establish positions. In this work, much of the literature reviewed bordered on: theoritical approaches to exchange rate changes; the role of exchange rate changes in Balance of payment adjustments; and the dynamic stability and choice between fixed and flexible exchange rates.

According to Milton Friedman (1953)[1], "If internal prices were flexible as exchange rates, it would make litle economic difference whether adjustments were brought about by changes in exchange rates or by equivalent changes in internal prices". While trying to justify the need for an understanding of the fixed and flexible exchange rate system, Mundell (1960)[2] attacked Friedman's proposition, nothing that although this view, "under certain circumstances, may be valid in statics, it is entirely erronous in dynamics". He continues:

> A dynamic analysis of the two systems is necessary to provide a description of the relative merits of fixed and flexible exchange rates - one system may work well (dynamically) under one set of static parameters and speeds of adjustment, but badly under another ... since the days of Hume's classic analysis of the price-specie-flow mechanism, the adjustment process has been rightly recognised as dynamic. Yet it is seldom stated, or even hinted, in expositions of the gold standard mechanism that an explicit dynamic model is necessary for examining processes that occur simultaneously but at different speeds.

The price-specie-flow mechanism was first expounded by David Hume in the eihteenth century and was sebsequently elaborated by others like Adam Smith, David Ricardo and John S. Mill. Then, it was regarded as a revolutionary notion as it led to destroy the

---

[1] Friedman, M. (1953) "The case for Flexible Exchange Rates". In Eassays in Positive Economics, PP. 157-203. Chicogo: University of Chicago Press.

[2] Mundell, R.A. (1960) "The Monetary Dynamics of International Adjustment under Fixed and Flexible Exchange Rates". Quarterly Journal of Economics, Vol. 74 (May), PP. 227-57. Reprinted in revived form as chapter 11 of R.A. Mundells International Economic (MacMillan, New York, 1968)

mercantilist view that an increase in exports leading to gold imports was desirable. According to Hume's classic analysis of the price-specie-flow mechanism, the market rate of exchange between the money units of two gold standard countries is anchored to the mint parity and the factors undelying the balance of payment adjust themselves to the mint parity exchange rate.

As to whether the fixed exchange rate system is still viable, David Kern (1982)[3] said "the fixed exchange rate system broke down in the early 1970s and... the world economy has operated under a system of 'floating exchange rates', in which most major currencies have been allowed to fluatuate in response to a variety of forces, whether commercial or speculative". He continues:

> The adjective 'floating' undoubtedly exaggerates the extent to which exchange rates have been allowed to move freely, and it is widely known that Central banks have intervened in the currency markets regularly and on a large scale. However, the fact that (as a general rule) governments have abandoned their commitment to the maintenance of a particular parity for their currency has involved an important structural change, with far reaching repercautions for economic policies. The main exceptions to the general practice of 'floating exchange rates' have been the various European currency 'blocs', which have aimed to maintain a more stable relationship between various currencies, usually those of the EEC members... However, it is important to bear in mind that neither the European Monetary System (EMS) or its predecessor were ever intended to establish a rigid link between the vaious currencies. Regular changes in the EMS parity structure have taken place.

Professor Gustav Cassel (1918)[4] agreed that the purchasing power parity between any two countries is that amount of currency of one country which endows the holder with the same amount of purchasing power, ie, command over goods and services, as would a

---

[3]Keren, D. (1982) "The International currency Markets". Journal of Institute of Bankers, (Feb), PP. 6-9.

[4]Gustau, C. (1918) "Money and Foreign Exchange after 1994" Economic Journal, Vol.31 December.

stated amount of the currency of the other currency.

To achieve relative stability under flexible exchange rates system, Marshall and Lerner in their elasticity theory agreed that the sum of import demand elasticities in the two countries (ie trading partners) must be positive. But Haberler (1976)[5] writes, "it is not unimportant to demonstrate, as the elasticity theory has done, that the exchange market may be unstable even if all underlying markets for exports and imports, considered seperately, are stable". The Marshall - Lerner condition according to Johnson (1976, P.28)[6] "is the condition for stability in a bater economy". Johnson goes on to write (1976, P.281)[7]; "As applied to the foreign-exchange market, given one world price level and nominal quantities of domestic money in the two countries (home country and rest of the world) there will be only one exchange rate that will give each country the real balance it desires". Thus in a world of fixed exchange rates, all countries will tend to have the same rate of inflation.

While commenting on the role of exchange rate changes in Balance-of-Payments adjustments, Kaldor (1971)[8] suggested that fiscal policy should be directed towards the balance of payments with the exchange rate used to determine the level of domestic activity by export-led growth. However, Ball, Burns and Laury (1977)[9] cast some doubt upon this suggestion saying "The output

---

[5] Haberler, G. (1976) "Review of Frankel and Johnson (1976)" Journal of Economic Literature, Vol.14. December.

[6] Johnson, H.G. (1976) "The Monetary Theory of Balance of Payments Policies". Chapter II Frankel and Johnso (1976).

[7] Ibid PP.281.

[8] Kaldor, N. (1971) "Conflicts in National Objectives" Economic Journal, March, Vol.81, PP.1-16.

[9] Ball R.J, Burns T. Laury, J.S.E. (1977) "The Role of Exchange Rate changes in Balance-of-Payment Adjustment: The United Kingdom case". The Economi Journal, Vol.87. (March), PP.21.

effect of the single exchange rate change is effectively transitory since the competitive advantage is subsequently wiped out by the adjustment of incomes to import prices restoring domestic costs to previous levels and therefore continual depreciation would be required for a once-and-for-all increase in output. Eventually even this may be undermined by rational expectations as the community anticipates the inflation". According to this view, "the exchange rate can only be regarded as an instrument of economic policy, to the extent that use can be made of its transitory effects, either to increase the level of reserves or to bring about other changes during the period of adjustment. With a floating rate, ... the rate provides an extral degree of freedom to pursue a rate of inflation in the long run different from that of our competitors". Although the Ball, Burns and Laury Model did not handle a fully floating exchange rate system, it was oriented towards a system which applied to the U.K economy for the most of the post-war period and it can be argued that it dose throw some light on the mechanism of exchange rate adjustment for the U.K. economy (Ball, Burns and Laury, 1977)[10]. They thus concluded that "with free collective bargaining, wages and prices are likely to rise by the full extent of the devaluation in the long-run".

Johnson (1976)[11] concluded that because the world market for manufactured goods is highly competitive each country try must accept the world price for its tradeable goods and through competition in the labour market this will spread to non-tradeable products. Thus, the failure of devaluation to change the long-run relative prices is not the result of workers refusal to accept a reduction in real wages. Rather it stems from the assumption of high elasticities of substitution between domestic and foreign

---

[10] Ibid PP.1

[11] Johnson, P.D. (1976) "Money and Economic Activity in the United Kingdom 1880-1970". Journal of Political Economy Vol.84, October.

allowed to float in which case the rate will be determined by the

goods.

In Ball, Burns and Laury (1977)[12], Meade argued that fiscal policy could be used to choose the employment level while exchange rate is varied to ensure external payment equilibrium. He however argued that this process could be reversed with financial policy aimed at the preservation of external balance and exchange rate adjustment for the preservation of internal balance. Also arguing from a protfolio balance approach, McKinno (1969)[13] stressed this reversal of the conventional role of the instruments by arguing that there is only one fiscal policy consistent with long-run external balance because in the long-run in a stationary economy the private sector should not continue to increase its holdings on financial assets. Once this condition is satisfied, then, oputput is determined by the ratio of exports to the marginal propensity to import and hence, in principle, changes in the exchange rate can be used to increase the equilibrium level of output.

It is important at this point to show the linkages between exchange rate mechanisms and the banking sector. An impotrant feature of the monetarist approach to devaluation for example, is that the rate of domestic credit expansion remains unchanged. But Mundell, (1971, P.92)[14] has suggested two reasons why this will be difficult.

a) because devaluation involves "profits" and the domestic currency value of central bank assets rise after devaluation,

b) because devaluation raises prices and reduces the real value of money - there will be upward pressures upon interest rates which the authorities will be tempted to offset.

---

[12]Ball R.J. Burns T., Laury J.S. (1977) "The Role of Exchange Rate Changes in Balance-of-Payments Adjustment. The United Kingdom case". The Economic Journal, Vol.87 (March), PP.4.

[13]Ibid PP.4

[14]Ibid PP.13

While describing the close link between interest and exchange rates as "a technical market relationship", David Kern (1982)[15] argued that ...."in many respects the frequent upheavals in the foreign exchange markets can be seen as a painful but probably unavoidable manifestation of the fight against inflation.

The literature reviewed above it is hope will help to examine impacts of exchange rate mechamisms on First Bank of Nigeria PLC within a given framework.

28.0 CONCEPTUAL FRAMEWORK

Exchange rate mechanisms whether classified by its role in balance of payments adjustments or interms of dynamic stability and choice between fixed and flexible exchange rates operates within a conceptual framework. Having examined the concepts relating to the subject matter, the researcher has come out with the following postulates which provides a theoritical foundation for many of the exchange rate and banking ideas discussed throughout the study.

Bankers, businessmen and government officials in many countries have clearly become increasingly concerned about the possible adverse repercussions of the unusually large fluctuations in interest and exchange rates. People in industry who have to make decisions about pricing and investment require a reseanably stable background and thus the buildup of major financial uncertainties has lowered business confidence and has reinforced the tendency towards a lower rate of economic growth.

2. One of the must crucial issues facing people responsible for financial decisions is the implications of prevailing rates for prospective movements in currency values. In theory, people holding assets of a weak currency, the values of which is expected to decline, should demand a higher rate of interest to commpensate them for the likely capital loss. Conversely, those holding strong currencies with an

---

[15] Ibid PP.8

appreciation prospect should be prepared to accept a lower yeild, because the capital value of their assets is likely to appreicate.

In a free money market, differences in interest rates are automatically reflected in the foward exchange market where currencies are traded for delivery on future dates.

3. The question of whether interest rates provide correct signals about future currency trends is a fundamental issue for most businessmen, bankers and governments. In a theoritical world, where people have perfect forsight, an interest rate gap would exactly match a future exchange rate movement. Unfortunately in practical situations, we are always faced with many uncertainties and a change in interest rates may be open to conflicting interpretations (Kern 1982)[16].

4. Following the introduction of the Domiciliary Account Scheme in October, 1985 which allowed individuals and corporate bodies to operate foreign currency accounts in Nigeria, the need for a free and open foreign exchange market became apparent (Adekanye, 1986)[17]. The Second-Tier Foreign Exchange Market (now the Autonomous Foreign Exchange Market) attempts to bring some flexibility to Nigeria's exchange rate system.

5. The objectives of establishing a foreign exchange market in Nigeria is to evolue a realistic market determined exchange rate for the naira so as to reduce the demand for foreign exchange to the available supply, reduce the pressure on the balance of payments to stop further accumulation of trade debt, reduce imports, stimulate exports and pave the way to self-reliant and sustainable growth.

6. Exchange control regulations in Nigeria are aimed at

---

[16]Ibid PP.8

[17]Adekanye, F. (1986) The Elements of Banking in Nigeria 3rd Edition, F & A Publishers, 176 Awolowo Road, Ikyoyi, Lagos.

achieving:

i. Conservation of foreign exchange

ii. Allocation of foerign exchange resources to various spheres of economic activities compatible with national aspirations.

iii. Encouragement of inflow of foreign exchange and attraction of foreign capital into the country.

v. Maintainance of the value of the naira-vis-a-vis other currencies.

iv. Promotion of export of manufactured, industrial and agricultural goods from the country.

7. Technically speaking, the impacts of exchange rate mechanisms on First Bank of Nigeria PLC is occassioned partly due to the monetary nature of the deposit liabilities of the banks. People use the banks for the purpose of making payments and as sources of loans, and efficiency in both these functions is desirable; the latter involves society's interest in the distribution, between different uses, of the resources that can be devoted to adding to the real capital of the nation. Beyond this lies the community interest in banks because by their operations they can affect "the monetary situation', in the sense of the availability of purchasing power. By a mere exchange of obligations- the essence of bank lending - there is usually an increase in the effective purchasing power at the disposal of the persons and corporations (including 'companies') who do the spending that constitute the total demand for goods and services. Thus the activities of banks influences the pressures of total demand.

8. The extent to which the community's productive resources are employed, and to some extent the prices and wages at which they are employed and the general level of prices of the products are to a large extent influenced by the presure of total demand being exented at any time. Hence the bank's

activities because they have effect on the monetary situation, have some bearing on exchange rate mechanisms and indeed on the brond functioning of the economy, in the sense of the degree to which its productive resources are employed and the behaviour of price levels.

9. Aside from effecting payments for clients, banks also creates liquidity in the economy. The exchange of promises between a bank and the borrower, though it usually increase total financial assests by no more than it has increased total financial liabilities it increases 'liquidity' in the economy.

For the avoidance of the avoidance of doubts, the researcher wish to disarm potential critics by emphasising that any concept which does not conform with or that contradicts the above concepts is not within the framework for analysis for this study and should not be assumed as such. However, this is not to give the impression that the conceptual framework used for this study is the optimal. Instead, this only serve to cave a boundary for the study.

2B.1 EVOLVING STRUCTURE OF THE NIGERIAN FINANCIAL SECTOR

The financial sector comprises of a network of financia institution or agents operating under set rules for rendering or regulating financial services, usually by providing or promotin financial intermediation. The elements which enhance the performance of this function are financial institutions, financia resources, financial rules and regulations and financia interactions. These elements and their linkages constitute th structure of the financial sector. To understand the emergin financial structure in Nigeria, it would be instructive to revie the evolution over the years. Prior to the establishment of th Central Bank of Nigeria (CBN) in 1958, financial institutions wer inadequate in terms of number, quality and variety. By 1958, ther were only seven viable commercial banks, some ill-equipe development finance institutions and a handful of insuranc

companies. Merchant banking was non-existent. Other characteristics laws; the dominance of foreign banks; dependance on British financial practices; inacessibility of many Nigerians to bank credit; limited banking habit; dominance of Government interests in indigenous banks; existance of a rudimentary financial market; and lack of an independent monetary system.

The estalishment of the CBN paved the way for other developments such as the adoption of monetary management by indigenous personnel, stricter laws and regulations, and improved institutional facilities. These coupled with te indigenization measures of the 1970s had, by 1985, brought significant structural changes which included further growth of commercial and merchant banks to 28 and 12, respectively; government acquisition of at least 60 percent majority shares in all licenced banks; the increased domestic influnce on banking activities; remarkable growth in banking habit as measured by higher deposits/money supply ratio; increased influence of government on the banking sector; revitalization of development finance institutions; further growth in insurance compaines to over 80, and the activation of the moeny and capital markets. However, despite the gaint steps taken since 1958, financial services at the turn of the 1980s remained poor and inefficient while resource allocation was hampered by excessive controls.

On response to the continued inadequacies of the financial sector, significant changes were introduced in the sector from 1986. These changes include deregulation of financial activities, credit administration, treasury securities trading, and monetary management, as well as the review and update of banking laws, the introduction of prudential guidelines and the relexation of licensing of financial institutions. Among other things this relaxation led to proliferation in the number of commercial and merchant banks to 66 and 64 by 1993, before falling to 64 and 51 by 1995, respectively following the liquidation of five banks

Innovative institutions emerged among which are the People's Bank of Nigeria, Community Banks, finance companies, discount houses, more specialised development banks, Primary Mortgage institutions and the Nigerian Export - Import Bank, as well as, for new regulators - the Nigerian Deposit Insurance Corporation for banks deposit insurance and the Federal Morgage Bank of Nigeria which added the regulation of mortgage institutions to its existing functions. In 1994, the Financial Services Re-regulation Co-ordination Committee (ESRCC) was set up to coordinate and streamline the activities of the increasing number of regulators in the sector.

By 1995, the emerging structure of the financial sector has become very complex, comprising the monetary authorities, the money market, the capital market, the foreign exchange market, development finance institutions and finance companies, as well as other innovative instutitions. At the apex of the structure are the monetary authorities comprising the CBN and Federal Ministry of Finance which exercise overall control. Another subsector is the money market in which the major operators are commercial and Merchant Banks, discount houses and community banks, while the CBN and the Nigeria Deposit Insurance Corporation are the main regulators. In the capital market subsector, the principal actors include, the Nigerian stock Exchange, the issuing houses, the stock brokers and the securities and Exchange Commission which is the lead regulator. The CBN and the Federal Ministry of Finance share the responsibility for regulating the Foreign Exchange Market whose components include the Autonomous Foreign Exchange market and the Bureaux de Change. In the development finance subsector, the main operator, usually established by statute include the Nigerian Industrial Development Bank, Nigerian Agricultural and Cooperative Bank, Nigerian Bank for Commerce and Industry and Federal Mortgage Bank of Nigeria which now controls the emerging mortgage institutions. Other operators are new forms of specialise

development finance institutions such as the Urban Development Bank, Maritime Bank and Education Bank as well as innovative institutions such as the people's Bank of Nigeria, the Nigeria Export-Import Bank, and the finance companies which operate in the informal sector until recently. Finally, in the insurance subsector, operators include insurance compaines and brokers whose regulators are the National Insurance Supervisory Board and the Federal Ministry of Finance (See appendix II).

28.2 THE ROLE OF COMMERCIAL BANKS IN EXCHANGE RATE DETERMINATION.

Early banking in Nigeria was developed for the purpose of financing international trade - export to Europe of raw tropical produce and import of manufactured goods to Nigeria. The Banks did not therefore bore particular responsibility for the growth of the Nigerian economy. The importer and the exporter, for example, could do business with each other without troubling themselves over credit risk or adverse movement in exchange rates. The banks took care of it all and made profit from the British textile mills, as well as producers of cocoa, cotton, rubber and groundnut, etc. But as from about 1930, the Nigerian business interest and administering power were agreed that banking policy and practice should reflect in some degree the requirements of the Nigerian economy. There and then began the gradual involvement of commercial banks in exchange rate policy in Nigeria especially as the Federal government began to hold huge equity participation in some of the major banks with foreign interest (ie First Bank of Nigerian Ltd, Union Bank of Nigeria and United Bank for Africa etc). By September, 1986, the commercial banks were set to play a key role in exchange rate mechanisms with the introduction of the structural Adjustment Programme (SAP) and the attendant deregulation of the exchange rate.

Traditionally banks provide the major vehicle for mobilising resources from the suplus units and chanelling the same to the deficit units. They also provide potent medium for the

transmission of government monetary policies in discharging its cardinal responsibility for economic management. Therefore in a developing economy such as Nigeria, commercial banks are one of the vehicle which recycle money. They are middlemen in the economy and their actions are governed by constraints set by goverment, regulatory bodies and monetary policy. They can only satisfy customers demand (private or public) in these respects and that demand is a function of economic policy and regulatory enviroment set by government.

One major aspect of deregulation exercise in Nigeria was the abolition of the import licence system and the introduction of the Foreign Exchange Market whereby banks featured as key players and channels for foreign exchange allocation. They become authorised dealers in foreign exchange by playing in termediatory roles, - ie acquiring foreign exchange for and on behalf or end users for a spread (usually 1%). By implication, Commercial banks were expected to bid for forex for and on behalf of their clients, ie, manufactures, importers, travellers, etc. Under the auction system forex was then allocated on pre-determined quota to highest bidders in each bidding session. The Dutch Auction system (which was first operated in 1987, abandoned in 1989, and reintroduced in 1990) required Commercial banks to pay for the foreign exchange allocations at their bid rates, while the accounts of the successful bidders were debited immediately with naira equivalent. In a bid to stabilise the value of the naira under the auction system and check the exeeess at the bureaux de change and the parallel market then used as reference points by the government in fixing exchange rates, official bidders developed a tacit collusion amongst themselves. Therefore, the amount of decipline exercised by commercial banks in the bidding sessions and the degree of speculative activities they resort to are very crucial in the determination of exchange rates. This is because the exchange rate to a very large extent is determined by the demand for and the

supply of foreign exchange at the Foreign Exchange Market and the commercial banks and other authorised dealers are expected to contribute in narrowing the supply gap in foreign exchange resources so as to shore up the value of the naira.

It has been the expectation that banks should provide a competitive front for the parallel market and the bureaux de change, however, where they become mischievous in their bidding just for the sake of getting foreign exchange for their client it will be certainly difficult to attain a realistic and fairly stable exchange rate for the naira.

With the unification of the autonomous market and the FEM into the Inter-bank Foreign Exchange Market (IFEM) in 1986, it was the hope of CBN that the measure would stamp out the emergence of multiple exchange rates which led to huge arbitrage profits by "forex hawkers". It was also the believe of CBN that the increasing demand for forex was a function of the level of liquidity in the system. Consequently, stabilization securities were issued from time to time as situation permited so as to mop-up "excess" liquidity and discourage inter-bank borrowing. It was a direct approach to monetary control with the impression that if banks are to make full deposits for their bids, a sequeeze in their liquidity level will lower their demand for forex. Nevertheless between September, 1986 to July, 1992, total forex allocation by banks to their clients from funds acquired from CBN and private sources amounted to $18, 985.38 billion.

When the demand side for forex could not be easily controlled by the first quarter of 1993, the CBN abolished forex allocation to banks and introduced new guidelines in a drastic move to stop malpractices that had characterized dealings in the Foreign Exchange Market. The measures included among others the following:-

i. No more forex allocation to authorised dealers on predetermined quotas.

ii. Banks were to obtain forex from any source and sell to their customers on presentation of approved documents.

iii. The CBN was to be both a seller and buyer of foreign exchange.

iv. Banks were allowed a spread of one percent between the buying and selling rates.

v. Restrictions on capital transfers were abolished with immedicate effect

vi Borrowing money for the purpose of capital re-patriation was disallowed while strict debt-equity ratios on all foreign investors in the country was proposed.

The above reforms implied that FEM was transformed into an interbank market with the CBN as a participant willing to buy and sell forex while other dealers directly execute the orders of their clients. The CBN was to influence the exchange rate only indirectly through an appropriate use of certain monetary policies.

By 1994, the thrust of the external sector policy was the re-regulation of the economy with the view to achieving external balance and stability of the naira exchange rate. Thus forex was centralised in the CBN, the naira exchange rate was pegged at N22 to US$1, Bureaux de change were to serve as agents of the CBN for the purpose of only buying forex for which they would be allowed commission (until later part of the year (1994) when they were allowed to sell forex), and there was to be direct allocation of forex to end-user by CBN. The point of interest here is that government wanted to centralise forex receipts in the CBN and direct its allocation in favour of productive sectors as against consumption and invisible imports. Furthermore, the fixed exchange rate was maintained, in the hope of providing an anchor for domestic prices.

Systematically therefore, the influence of the banks in the determination of the exchange rate had been gradually marginalised This is because by 1995, following the re-introduction of the

Autonomous Foreign Exchange Market, there was to be no regular bidding or allocation of forex at CBN. Instead, the CBN was expected to intervene in the AFEM in order to ensure reasonable stability in the market. Funds acquired by banks at the CBN forex intervention were to be allocated directly to end-users. The official exchange rate remained at N22 to the US dollar while all other forex demands were satisfied at the prevailing rate in the autonomous market. The Bureaux de change were re-authorised to purchase and sell forex not exceeding US$2,500.00 per transaction at a margin of 2.0% above the autonomous rate. In order to enhance the supply of forex to the domestic economy, exporters were instructed to open domiciliary accounts with authorised banks to which they would have unrestricted access.

So, technically, within the last six years, overall direction of policy pursuits has not been particularly consistent, as it has moved from deregulation to controls in 1994, and to partial deregulation in 1995. By so doing, the commercial banks are placed in a very difficult position. One can not actually evaluate their role in exchange rate determination in the Foreign Exchange Market due to the policy induced "shocks" of the recent past's administrations.

2B.3 DETERMINATION OF EXCHANGE RATE

Governments are usually concerned about ensuring realistic and fairly stable exchange rate for their national currencies. A stable exchange rate regime reflects a very strong domestic fundamentals which could result in the strengthening of the values of the domestic currency against the foreign currencies in which the reserves are kept. The exchange rate of a country may be fixed, managed or allowed to float in which case the rate will be determined by the interplay of market forces notably the demand for and supply of the currency in the foreign exchange market.

Alhaji Abdurkadir Ahmed (1992)[18] in a speech to chartered Institute of Bankers of Nigeria stressed that "the exchange rate reflects the economic condition of the country in relation to the rest of the world and any attempt to fix it arbitrarily will prove unsuccessful and unwise ultimately". Of course, Alhaji A. Ahmed is known in many quarters as an apostle of the Structural Adjustment Programme (SAP) which favoured the free market system in all facets. In practical terms, what determines the external values of the domestic currency is the foreign exchange earnings and expenditures of a country. In a free floating exchange rate system, the exchange rate is determined at a point where the supply of and demand for foreign exchange are equal.

Generally speaking, in Nigeria, the exchange rate of the naira relative to other currencies has been administratively determined. From 1960-1986, the determination involved various methods, ranging between fixed attachment of the currency to either the pound sterling or the Unites States dollar, a system of independent floating, and the use of a basket of currencies, depending on the domestic and global economic situations.

By 1987 when the Foreign Exchange Market (FEM) was introduced to give more force to the deregulation stance, the pricing methodology for exchange rate involved the use of the closed Dutch Auction system whereby the CBN called for bids from authorised dealers (banks) once a week or a fortnight for available foreign exchange. Also used was the determination of effective rates using "Average of successful Bid rates" and the "marginal rate". Later on the official rate was determined by the CBN in accordance with the market situations. For example, the average official exchange rate for 1991, '92, '93, '94, '95, '96 and '97 were N9.9095 N17.2985, N22.0468, N21.8861, N21.8861, N21.8861 and N22.046 respectively to US$ 1 while the average AFEM rate for 1995, '96

---

[18] Ahmed, A. (1992). "The state of the Nigerian Economy and the Policy options". Bullion, Vol.17, No.5, November.

and '97 were N81.149, N81.2527 and N81.2538 respectively to US$1

Superficially, the exchange rate seem to be stabilised in the recent past 3 years since the introduction of the AFEM in 1995. But one may ask these simple questions; has the country improved in its foreign exchange earning portfolio or how are we "morally disciplined" with the much forex we have; are the uses we commit the available forex more of such that can generate us more forex or are they merely for consumption and invisible imports? Answers to these teaming questions are actually the determinates of exchange rate in the practical sense.

It is worth of note that exchange rate might be determined via devaluation especially when there is perceived over-valuation of currency or when a country wish to encourage exports. For imports dependent economies, however, devaluation may not yield much dividends because it will only increase your costs as your currency is cheapened relative to other currencies. Also foreigners who denominate their contracts in the devalued currency will have less value for them relatively. The situation may be worsened if your goods can not compete favourably in the foreign markets. The impact of devaluation on exchange rate usually even out in the long run under a free floating exchange rate system because of the demand for and supply of currencies at the forex market- ie, although in the short-run the market rate of exchange may be either lower or higher than the mint parity rate of exchange, in the long run it tends to be equal to it because when the market of foreign exchange deviates from the mint parity rate of foreign exchange, forces of equilibrium will operate until equilibrium is restored.

The market rate of exchange between the money units of two gold standard countries is anchored to the mint parity and the factors underlying the balance of payment adjust themselves to the mint parity exchange rate. When a country has a deficit in her balance of payments, the equilibrium in the balance of payments of the country is brought about through a chain of causation and

counter-causation. In other words, through the inflationary process in the gold-receiving country and deflationary process in the gold-losing country, equilibrium in the balance of payments of both the gold standard countries is restored. However, the balance of payments equilibrium with fixed foreign exchange rates is possible at the heavy cost of sacrificing the domestic cost-price stability in the two countries. This classical analysis is known as the price-specie flow analysis. The price-specie-flow mechanism under the international gold standard occupied prominent place in the classical explanation of determination of exchange rates. This is because like many other classical explanations, it stresses the importance of price changes in bringing about and maintaining the balance of payment equilibrium.

The mint parity theory of detremination of exchange rate seek to explain that when two countries are on the full-fledged gold standard, their currency units are either made of gold of given purity and weight or are freely convertible of given purity at fixed rate- ie, in short, the gold value of the money units is unambiguously determined. Under gold standard, countries maintain the value of their currencies in a fixed relationship to the value of gold by committing themselves to buy and sell gold at fixed prices. A nation is said to be fully on the gold standard if the government of that country (i) buys and sells gold in unlimited quantity at an officially fixed price, and (ii) permits unrestricted gold flows into and out of the country. By implication, therefore, an individual who holds domestic currency knows in advance how much gold he can obntain in exchange for it and how much foreign currency this gold will buy when exported to another country. Under this condition, the exchange rate between gold countries will (all things being equal) fluctuate around the fixed mint par within the narrow range determined by the cost of exporting and importing known as the SPECIE POINTS. The mint parity theory of foreign exchange rate is applicable only to

countries on the same metallic standard. Thus, there can be no mint par between a gold and a silver standard country.

The purchasing power parity theory of exchange rate determination has it that, the normal equilibrium rate of exchange between two inconvertible currencies is determined by the ratio of their purchasing powers. The rate of exchange tends to stabilise at the point of equality of the purchasing powers of the two currencies. The main difference between the mint parity and the purchasing power parity is that while the former is a fixed parity the purchasing power parity is a moving parity which is determined by the quotients of the purchasing powers of the different currencies (ie it moves with the variations in prices in the countries concerned).

The determination of foreign exchange rate for the naira since independence has been in line with existing theoretical undertones. However, each theory holds true only when it is fine turned to suit specific developmental aspirations of a country. Thus, Nigeria in the light of experience, can not at one time apply any of these theories undilutedly, since each existing theory has draw backs given certain unavoidable peculiarities, and or constraints.

28.4.0 **EXCHANGE RATE ADMINISTRATION UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME (SAP)**

Historical trends in exchange rate mechanisms reveal that the exchange rate of Nigeria's currency during 1960 to September, 1986 were administratively determined. The determination involved various methods as shown in 28 above. Consequently, the exchange rate was stable at ₦0.7143 = US $1.0 from 1960 to 1970. As a result of the collapse of the Bretton Woods arrangement, the stability was distrubed in 1971, making the currency to appreciate consistently reaching ₦0.6077 = US $2 in July, 1975 when Nigeria was receiving substantial inflow of foreign exchange from the crude oil export. The reserves declined in 1976 and a deficit balance of payment was recorded, causing depreciation of the Naira to an average of

₦0.6226 = US $2.0 and ₦0.6467 = us $ 1.0 IN 1976 and 1977 respectively. The value of the currency thereafater improvec reaching the high peak of ₦0.5314 = US 1.0 in October, 1980. From 1991, the value of the currency was adjusted downward consistently in line with the change in Nigeria's fortune in the depressed crude oil market. On the average the naira was depreciated to ₦0.6729, ₦0.7247 and ₦0.7648 to the United States dollar in 1982, 1983 and 1984 respectively. As the situation became increasingly critical, the pace of depreciation increased in 1985 and 1986 when the currency averaged ₦0.8938 and ₦2.0210 respectively to the Unitec States dollar. All this while, in order to bring about economic recovery, stringent control measures on trade and payments were employed especially between 1984 and August 1986 by the government. These measures were directly or indirectly to support the value of Naira.

The greatest water-shed in the economy since independence occured in September, 1996 when General Ibrahim Babangida Nigeria's military President introduced SAP that promoted a new economic doctrine which sought to beat back the frontier of the state from economic conduct and firmly institute a private sector principle. By 5th March 1992, the Foreign Exchange market was deregulated in a bid to close the gap betweed the parallel market and the official rates which was observed had widened to 80 percent. By this development it was expected that CBN will always meet whatever amount of forex demanded by banks in order to make the FEM efficient. However, contrary to expectations CBN unilaterally had to suspend forex sales, sometimes; on the excuse that authorizec dealers (banks) were engaged in forex back-door dealing; on the need to guage the temper of the 1993 budget; and on the ground that authorised dealers bidded outrageously. The Dutch Auction System (DAS) was introduced in 1987, abandoned in 1989 and re-introducec in 1990. The DAS system favours high bidding and discourages low bidding and hence its weakness. According to Mr. Victor Odozi," the

Deputy Governor (Domestic Monetary and Banking Policy) CBN, the Dutch system of forex allocation was no longer feasible, in spite of its attraction as a market instrument". By the close of December, 1992, it was observed that the gap between the parallel market rate and FEM had narrowed from 80% to 20%. This gap had persisted because of intractable demand side trends and the very fact that the supply side had responded rather slowly, if at all, to various exchange rate induced policy initiatives.

Though SAP was a "child" of circumstance with an initial two-year time frame, there was need to fine-turn the policies which SAP sort to stabilise - hence the need to elongate its life span beyond 1988. However, Macro-economic policy pursuits seem to be gradually parting ways with SAP as it has moved from "deregulation" to controls in 1994, and to "guided deregulation" in 1995 to date.

2B.4.1 EXCHANGE RATE LIBERALIZATION UNDER THE FOREIGN EXCHANGE MARKET (FEM)

What gave birth to a liberalised foreign exchange market was the general believe that the naira was over-valued due to the fixed exchange policy characterised by trade and exchange controls. The over-valuation among other things boosted consumer goods import, deepened industry's dependence on imported inputs, and encouraged capital flight and the growth of a parallel market in foreign exchange,and led to smuggling and corruption in the allocation of import licences. The naira over-valuation made it unprofitable to produce for exports, with importation guaranteeing a higher return. Consequently, the need to cheapen our domestic currency through devaluation had to be supported by a liberalized or deregulated FEM so as to curtail demand for imports, encourage capital inflow and non-oil exports, improve balance of trade, eliminate corruption that characterised the import licensing and above all determine a realistic exchange rate of the naira.

In conformity with the liberalisation policy of SAP, Government took certain radical action in 1986 strictly directed to

making the new system work efficiently. The second-tier Foreign Exchange market, Decree No.23 of 1986 abolished the exchange controls and import and export licensing. Earlier in another promulgation the erstwhile Commodity Boards were aborgated, thus privatising commodity exports. Exporters became owners of all their forex earnings which they could use to undertake eligible transaction, keep in domiciliary account in Nigeria or sell outright to authorised dealers. The same applied to any foreign exchange earners. Funds from private sources could be traded by authorised dealers amongst themselves; indeed, this was the main source of funding the autonomous market. But it is prohibitive to use funds obtained from CBN auctions for inter bank transactions.

The Bureaux de change was therefore licensed as authorised dealers in forex so as to attract smaller amounts of foreign exchange and marginalise the black marketeers. Under the deregulated FEM, more banks as were licensed had automatic right to participate at FEM to provide competition necessary for the emergence of the realistic exchange rate.

In 1992, restrictions on capital transfers were abolished. However, no borrowing was allowed from local sources for the purpose of repatriating funds. The CBN also became an authorised dealer, free to buy and sell foreign exchange to other authorised dealers at the prevailing market rates. In an attempt to minimize speculative bidding by banks, their accounts (i.e banks) with CBN were to be debited with the naira equivalent of the bid amount immediately they record a successful bid in each bidding session.

If the liberalisation of FEM was to determine a realistic value for the naira, then one will not be out of line to think that the naira has not yet had a realistic value, because the demand for and supply of the currency has not yet got to an equilibrium position since SAP was introduced in 1986.

28.4.2 BUREAUX DE CHANGE

Bureaux de change is a euphemism for petty foreign exchange

dealers. It was introduced in August, 1989. Presently, they are allowed to buy foreign currency note and coins as well as travellers' cheques freely and sell foreign currency note and coins as well as travellers' cheques freely and sell foreign currency notes and coins up to a maximum of US $2,500 per transaction at autonomous rates subject to a margin of 2 percent.

Operators of Bureaux de change are duly licenced agents in the business of buying and selling foreign currencies at designated points throughout the country. They exist to produce free access to forex especially to small buyers in a convenient and informal manner, thereby filling the gaps left by banks. Thier operations are legitimate, and since they are registered, control by the apex bank is possible. In this way, fiscal efficiency is increased through more adequate statistical coverage of foreign exchange flow.

Since the establishment of Bureaux de change in 1989, it made black market less attractive. However, it may be adverted here that the exchange rates of the Bureaux de change more or less has been along the same line with the rates of the parallel market. Basically, the Bureaux de change was established to take care of undue delay in getting forex allocations, incredibly high administrative charges for small allocations and alleged discrimination and preferential treatment on the part of authorise dealer banks. But experience has it that bureaux de change had come to be a verile competitor not only to the black marketers but also to authorised dealer banks thus posing a great challenge to banks in terms of their annual earning on foreign exchange transactions.

2B.4.3 THE BLACK/PARALLEL MARKET

The ultimate intention of the deregulation of FEM by March 1992 was to wipe out distortions in the system and restor stability in the exchante rate through government's removal o subsidy on forex as well as government monopoly in the sell o forex, thereby, bridging the gap between official and paralle

market rates. So, in government quarters, the parallel market act as a reference point for the CBN's rates. To them the search fo the realisitic exchange rate for the naira would be incomplet without a parallel market to weigh side by side the exchange rat of the naira in the FEM and the Bureaux de change. By narrowing th gap between these two rates, government intended to marginalise th black market.

The parallel market rate is the rate at which currencies ar exchanged at minimum transaction costs. In the limit, th difference between the official exchage rate (FEM rate) and th parallel market rate represents the full value of the trasactio costs for access to the official mardet. The patronisers of th parallel market can be categorised into two groups, the buyers an the sellers. The buyers are those who would want to procure mone for their travels, those who would not want to pay duties on the imports. Sellers are those who are interested in negotiation fo the highest returns on the dollar on their shores.

Sam Aluko, a renowned professor of economics in 1992 observe that "instead of government wiping out the black market and makin it illegal, they now use it as the barometer for measuring th realistic rate of the naira". According to him, "no serious countr does that" So, now the question is, what is illegal about the blac market? like the case of smugglers, hard drug marchants, currenc traffickers and other forms of illegal businesses, the activitie of the black marketers are illegal. Their activities are costin the economy a great deal in loss of revenue. They neither pa license fee, neither do government collect taxes from proceeds o their business. It is alleged often that even banks sometimc direct most of their forex allocation to the parallel market. The buy from CBN at "cheap" FEM rates and sell to end-users a exorbitant rates instead of the stipulated one percent spread.The sometimes engage in "under-the-counter" deals hence undermining th credibility of FEM. All these have painted the parallel market a

been characterised with shoddy deals and thus illegal. Using th parallel market as a reference rate for fixing FEM rates, ma therefore, be misleading in a modest sense given the abov intrincacies that characterise the parallel market and the legacie it stands by.

Ironically, deregulation of FEM did not produce the "fruits" which the government credited to it initially when the seed wa sowed: Closing the gap between official exchage rate and the parallel market rates. Although the gap narrowed shortly after the deregulation from about 80percent at the begining of march, 1992 to about 5 percent at the end of the month, it again rose to about 20 percent at December, 1992 and rose further in 1993 and 1994 forcing government to bring back limited controls. From 1995 till date, the policy pursuits has placed emphasis on "guided deregulation" with the operation of dual exchange rates: ie the official rate fixed by CBN for government forex demands and the autonomous rates in the Autonomous Foreign Exchange market. Despite these measures the gap between the parallel market rate and the AFEM rate remain significantly wide. Nevertheless there is relative stability of the naira exchange rate at the automomous foreign exchage market.

28.5 CAUSES OF PERSISTENT DEPRECIATION OF THE NIARA EXCHAGE RATE

Prior to the deregulation of the FEM effective from september 1986, the naira was generally believed to be over valued due to the fixed exchange rate policy characterised by trade and exchange controls. But as years rolled by, there had been sustained decline in the value of the naira from N4.6210 on 29th september, 1986 to about N8.00 per US dollar as at 5th March 1992. By 18th Febuary, 1993 the naira exchanged at N24.99K. In 1994 it was administratively fixed at N22.00 per US doller and form 1995 till date two rates are operational, the official rate averaging N21.8861 and the AFEM rate averaging N81.2527 Per USkoller (Bullion, Jan-March, 1997 Vol.21, No1).

The high exchange rate has been blamed for the soaring

inflation, poor performance of the Nigerian goods in the export markets, capacity under-utilization in industry, breakdown in social infrastructure, general decline in the standard of living, supply deficiencies at FEM etc among other things. These factors may be classified under three major sub-headings, namely, the nature of the economy, fiscal and monetory devolopments and elemnts of indecipline.

(i) Nature of econgmy

One of the principle concern of SAP was to reduce dependance on the oil sector as pricipal forex earner. However, the nature of the ecomomy did not warrant this sudden shift in emphasis owing to the constrained nature of production of non-oil exports. There is a constraint arising from inability to expand output due to structural weaknesses in the system. Our economy therefore, cannot enjoy comparative cost advantage in international trade, since there exist very high propensity to source for imported raw material inputs for our industries. Also, there is constraint arising from the uncompetitive nature of our product both in terms of quality and cost. Our exports quality hardly justify their prices in the foreign markets. There is also constraints in the seasonal nature of production of agricultural products as well as lack of storage facilities. All this makes our earnings from non-oil sources very low. Since the spin-offs of the oil sector are very small and the price of oil is exegenously inflenuced, we ofter find ourselves floating while relying on the mercy of "chance" to turn our fortunes by way of increased oil prices.

(ii) Fiscal and Monetary Developments

a. The influence of government expenditure:

The most successful year of SAP was in 1987 when an average of N4.0719 exchanged for the US dollar. The introduction of the reflectionary budget with general upward increased in salaries in 1988 to ease some of the apparent pains of SAP marked the begining of escalating domestic inflation and high demand for forex at the

AFEM thus depreciating the naira further.

Since 1988 government expenditure had been on the increase an thus deficit financing. In an economy so heavily dependent o imports, the adverse effect of the deficits financing on the valu of the currency has been serious because a large portion o expenditure normally goes for imported items and this is one majo source of instability in the value of the naira.

b. Private sector expenditure.

Usually due to the interplay of many factors government expenditure feeds into private sector expenditure bringin considerable pressure on the exchage rate. For example, if government increases minimum wages, the private sector may react more positively and increased even beyond the minimum specified so as to source the best manpower that give them the much needed added-value for their products and services offered in a competitive market. Apart form the above, some banks and non-bank financial institutions until 1989 engaged in the practice of accepting foreign essets as collaterals for granting loans without bringing in any funds. This practice contributed to monetary expansion which had adverse effect on the Naira exchage rete. CBN had to prohibit the practice in April and may 1989.

c. Elements of Indecipline

Just as malpractices thwarted the erstwhile exchange control objectives, in the course of operating the FEM, indecipline has been indentified as a stumbling block to the realisation of a stable exchange rate. FEM was designed with certain institutional and regulatory measures to ensure its success. But indecipline in the system could not make it work as desired. They had been alleged "under the counter" deals by authorised dealers (banks) which undermined the credibility of FEM.Some of the deals include the diversion of forex soured from FEM to the parallel market to make autrageous profits.

There were also indecipline resulting from high speculative

bidding at FEM by authorised dealers so as to get forex for their clients since allocations were based on highest bidder basis.

Also to be noted is the indecipline derived from the lack of a clear vision by the CBN of the optimal system that would gurantee the stability of the naira resulting in rampant changes in policy pursuits which increased speculative activities at the FEM.

2B.6 IMPACTS OF EXCHANGE RATE MECHANISMS ON COMMERCIAL BANKS

It is the tradition of commercial banks to provide vehicles for mobilising resources from surplus units and chanelling the same to the deficit units. They also provide a potent medium for the transmission of government monetary policies in discharging its cardinal responsibility for economic management. Therefore, since banks are the major vehicle which recycle money in Nigeria, they are the middlemen in the economy and their actions are governed by constraints set by government, regulatory bodies and monetary policy. They do not create demand, whether in local currency or in foreign currency. They only attempt to satisfy their customers demand (private and public) in these respect and that demand is a function of economic policy and regulatory environment set by government. Impacts of exchange rate machanisms on commercial banks can be broadly catergorised into positive and negative impacts.

(a) Positive impacts

One major aspect of the deregulation exercise was the abolition of import licensing system. This had a profound effect on the roles of banks in the ecomomy as they now function as major channels for foreign exchange allocation to end-users. They bid for forex on behalf of their clients for a spread. Until the introduction of Bureaux de change in August 1989, banks had the sole monopoly over forex allocation especially to private demand wherein enormous profit accrued from these services. Infact, when SFEM and IFEM was threatened by the forces of demand and supply at the Bureaux de change and parallel market, there developed a tacit collusion amongst official bidders (ie banks) in a desperate bid to

stabilise the naira during the period.

Exchange rate induced macro-ecomomic policy framework aimed at minimising inflationary prossures and hence stabilising the naira exchage rate has directly or indirectly contributed to enhance prudence in the banking industry as well as improved competition. For example the credit guidelines issued by CBN in 1989 in the monetary circular No 23 of 1989 and its Amendments among other things help to sanitise the banking system. In the circular, for example, the CBN warned against granting naira-demoninated loans based on security of foreign gurantees or foreign currency deposits held abroad or in domiciliary accounts. The panalty for defanlt was also stated.

Also with the establishment of the (NDIC) Nigerian Deposit Insurance Corporation in 1988 and the licensing of as many banks as possible in the wake of deregulation, armchair banking gave room for effective competition for deposits. Many commercial banks have also introduced new products in order to cope with the competition in the market.

Forthermore, the introduction of the prudential Guideliness in 1990 and Decree No 24 (CBN) and Banks and other Financial institutions (BOFI) Decree No.25 of 1991 has brought alot of financial prudence in commercial banking. As key players in the ecomomy each commercial bank has a legal, social and moral duty to remain viable and efficient so as to be able to protect the depositors savings and investment and to contribute effectively to the social-economic development of the nation.

(b) Negative Impacts

Market determined foreign exchange rate paticularly have a far reaching effect on the banking sector in general and commercial banks in particular. The negative impacts are also legion.

Since exchange rate mechanisms directly affect domestic price levels and purchasing power in the ecomomy, in lthe short-run, it has visited hardship on commercial banks in particular and other

businesses in gerneral because while the savings rate decreas because depreciation makes people spend more to consume and leav less or nothing to save, the banks on their side need more workin capital to operate effectively. As a consequence while there is growing demand for credit from the commercial banks on the on hand, there is an unprecedented rise in the number of non- performing loans in banks loan portfolio on the other hand.

Obviously, the adjustments of the naira exchange rate indiscriminately and subsequent derequlation of interest rate which led to explosion in interest rates had the spin-over effec of affecting the quality of lending portfolios of many commercia banks. Many borrowers become unable to service rising interes rates obligations and the number of non-performing loans increase as days or years roll on. While this implied less funds fo recycling to other borrowers, there was on the other hand an acros the board increase in demand for credit to finance larger workin capital requirements. To compound the problems, there were credi growth constraints, higher liquidity ratios and stabilizatio debits from the CBN to cope with. All this policy pursuits of CB were in one way or the other aimed at stabilizing the naira by wa of mopping up excess liquidity in the system. Hewever, th liquidity "Mop-ups" by CBN have succeeded in distabilising th money market, thus creating public uncertainty and speculation.

Ralph Oseyemeh former managing Director of commerce Bank PL noted that the liquidity "mop-ups" has not curtailed inflation bu only throw into jeopardy the creadit ability and credit planning o banks. According to him the haphazard and inconsistent way in whic CBN policies manifest have made treasury management very difficult

Constant changes in exchange rate induced policy measures als pose a serious threat to commercial banks and investors in general This is because investors need stability in order to make mediu and long term investment decisions. The frequent changes in polic combined with poor incentives to investment, bureaucracy ar

corruption hinder the effective functioning of commercial banks in Nigeria. For example, some banks who felled victim of the stabilization debits from CBN were drained of loanable funds and had to recall loan facilities already exposed. That was aside from an indefinate suspension order slammed on further lending. This kind of uncertainty was not condusive for any sound growth in business.

Apart from the above scenario, investors, lenders and borrowers using the inter-bank rates were exposed to very high exchange risk which led to huge financial losses in some commercial banks. The concellation of the Febuary, 24th 1993 foreign exchange market session, for exemaple, did not argue well with some commercial banks that hiked their bids so as to secure forex for their clients. Those worst hited included First Bank of Nigeria PLC, Union Bank and the United Band for Africa among others.

The liquidity and credit squeeze policy has a dual effect on savings. There is the likelihood of falling incomes as a result of decreasing investments and employment on the one hand, and rising interest rates on savings on the other. The withdrawal of federal and state governments and their agencies funds from bank and lodgement with CBN in 1989,for example, had far reaching implications. Many commercial banks could not afford to provide the naira cover for their allocations at FEM as well as other foreign transactions. It also resulted to increased interest rate at inter-bank market.

The point of illustration here is that, monetary authorities should seek consistency in policy objectives and in the ways in which these objectives are pursued. Otherwise, in a bid to prescribe medicine for one ailment, they may generate a chain of other problems that might be worse off and whose solution may not need simple fine-turning but a radical departure from the original policy objective. So since commercial banks play a significant role in exchange-rate mechanisms, government policy objective should

strike a balance between maintaining a sound financial system and a stable exchange value for the naira.

2B.7 RECENT TRENDS IN EXCHANGE RATE MECHANISMS

2B.7.1 FLUCTUATING EXCHANGE RATES AND I.M.F

One may observe that though the international monetary Fund (IMF) was created more than three decades ago in 1946 to among other things promote exchange rate stability without subjecting the members to the rigid discipline of the gold standard in the matter of national monetary management, freely floating exchage rates are not very uncommon. For example, Mexico, Canada, Peru, Lebanon, the Syrian Arab Republic and Thailand have had free floating rates for relatively long period of time dating as far back as 1954 and beyond. The ultimate objective of the Fund even in cases of exchange reform, has been to create the conditions for the restoration of a stable and unified foreign exchage rate. The fluctuating exchange rate has been to create the conditions for the restoration of a stable and unified foreign exchange rate. The fluctuating exchange rate has been regarded therefore, as a temporally means to an end. The Fund has regarded a general system of fixed exchange rates and institutionally agreed par values as superior to a system of fluctuating exchange rate. This is born out of the Funds recongnition that there may develope certain unusual circumstances forcing the country to adopt fluctuating exchange rate.

In the case of Nigeria, the fund is pleased with the overall policy thrust of the Federal Government of Nigeria. The executive Board of the IMF discussed the 1996 IMF Article IV consultation Report on Nigeria in January, 1997 and expressed satisfaction on the broad picture of the economy. However, it had reservations one some key areas, including the dual exchange rate pokicy, the apparantly expansionary 1997 budget, and improved relations with the Paris club creditors. The Fund indicated that improvement in the identified areas were preconditions for the negotiation of a

Staff Monitored Programme (SMP), which itself is a precondition fo negotiating the Medium Term Ecomomic Strategy (MTES) for Nigeria After subsequent meetings with the IMF and FGN, the IMF delegatior were satisfied that the major outstanding obstacle to thc negotiation of the SMP was the unification of the exchange rates. It is implied, therefore, that the IMF are not in support of the present dual exchange rate system in Nigeria.

2B.7.2 ADJUSTABLE PEG (AP) AND CRAWLING PEG (CP) EXCHANGE RATE SYSTEMS.

In recent years, the debate for and against 'fixed' and 'fluctuating' exchange rate systems has become increasingly intense. Consequently, various new proposals aimed at achieving greater degree of exchange rate flexibility while still retaining the important aspects of the "Bretton Woods" adjustable peg system have been advanced. One such proposal advanced as an atternative to the adjustable peg exchange rate envisaged under the IMF scheme is the system of

crawling peg exchage rate. The crawling peg exchange rate system espoused in tha mid-sixties by economist of the eminence of Willian Fellner, John .H. Williams, J. Black, James.E. Meade and Carter J. Murphy, is largely based on the argument that the major determinant of the effectiveness of any exchage rate system is the effect it has on the speculative movements of international money. Speculative capital flows are stimulated if and when the financial community feels that an exchange rate is likely to be changed so that it can make profit by shifting funds from weak currencies to strong currencies. Under the crawling exchange rate system, the exchange rate is allowed to crawl within the band of either side of the par value. In December 1971, the margin by which exchange rates could diverge from their par value had been widened from 1 percent to 2.25 percent on either side of the exchange parity. This in effect means that in place of the old system of adjustable peg, a new system of crawling peg had been introduced in the IMF scheme.

Under the new scheme the exchange rate could comfortably craw within the overall wider range band of 4.5 percent in place of th earlier 2 percent band rage. It was argued that the introduction o a wider range band would help equilibrium capital flows whil discouraging disequilibrum speculation.

2B.7.3 NEW EXCHANGE ARRANGEMENTS.

Under the ammended Articles of Agreement of the Fund tha became effective from 1 April, 1978 each member shall avoid manipulating exchange rates or the international monetary system ir order to prevent balance of payments adjustments or to gain an unfair competitive advantage over others. The reform allow the fund to determine by a high majority of 85 percent of the total voting power for introduction of a widespread system of exchange arrangement based on stable but adjustable par values. A member is free to establish or not to establish a par value for its currency.If a member however, establish a par value for its currency, such a par value can be established in terms of the special drawing right or in terms of such other common denominator as is prescribed by the Fund. The common denominator shall not be gold or currency. A member that does not establish a par value for its currency shall consult with the Fund and ensure that its exchange arrangements are consistent with the purposes of the Fund and are adequate to fulfill its obligations under Article IV, Section 1. The fund shall exercise surveilence over the exchange arrangements by overseeing the international monetary system in order to ensure its effective operation.

(iv) SPOT AND FORWARD EXCHAGE RATES

There are spot rate of exchange and forward rate of exchange ruling in the foreign exchange markets. The spot rate of exchange is the rate or price expressed in terms of the home currency which is payable for spot delivery of a specified type of foreign exchange. The forward rate of exchange is the rate or price which a transaction will be consummated at some specified time in future.

In actual practice, there are many spot rates of exchange, the spc rate for cables (telegraphic transfers) being different (usuall higher) from the one applicable to cheques and commercial bills. I modern times, the system of forward exchange rate has actually bee developed to minimise risks resulting from the possibility o fluctuations over time in the spot exchange rate to importers an exporters. The utility of the forward rate of exchange therefor lies in the ability of the importers and exporters of goods to kno in advance the prices of their goods which they are about to expor or import.

2B.7.4 ARBITRAGE

Geniune concern has been expressed over the increase i arbitrage of foreign exchange. Arbitrage is simultaneously buyin a currency in one market and selling it in another at a smal margin of profit which results from inconsistencies in foreig exchange rates in different parts of the market. In the case o Nigeria, it is buying forex from the Autonomous Foreign Exchang market or buying at the official rate of exchange and selling i the parallel market or the Bureuxe de change.Arbitrage is conducte by few large institutions, mostly banks, which possess th necessary capital and contacts for prompt purchase and sale o forex on a large scale and which can afford to obtain a very small rate of profit. The ecomomic importance of arbitrage operation flow from the fact that such operations remove the discrepancies i the rates of exchange between different international financie centres. Arbitrage in foreign exchange may either be spot arbitrage or forward arbitrage. Another form of arbitrage frequentl mentioned since 1958, is "covered interest arbitrage". Exchange controls requiring the residents of a country to surrender all their foreign exchange earnings to the authorities completly hinder the activities of arbitragers which consist of buying and selling of foreign currencies.

28.7.5 SPECULATION

Speculation in forex has been a common feature in the FEM. Speculators in foreign exchange distribute their assets and liabilities over the currencies of the world in a manner so as to take maximum advantage of expected changes in exchange rates. In order to maximise this benefits, a speculator has to adopt "long" and "shot" positions in particular currencies. In case of expected appreciation of the currency he buys the currency in expectation of capital gain on later sales, i.e he is a "bull" of that that currency.Conversely,he sells the currency in the expectation of a capital gain on later purchase,i.e,he is a "bear" in that currency. Importers and exporters may sometimes also dabble in speculation although they usually cover exchange risk.

CHAPTER THREE:

HISTORY OF THE CASE STUDY

3.1 INTRODUCTION

The First Bank of Nigeria PLC is a leading banking institution in Nigeria with more than a hundred years of banking experience and resilience behind it. Founded in 1884 by a shipping magnate in liverpool, Sir Alfred Jones, the Bank commenced as a small bank in the office of Elder Dempster and company in Lagos. Today, First Bank of Nigeria PLC have diversified into a whole range of activities including commercial, Merchant and international banking, and has become historically, a potent factor in the development of the country.[19]

In this chapter, the researcher would briefly but concisely reveiw historical trends in First Bank of Nigeria PLC especially on issues relating to the banks growth, organisational structure, ownership structure, staff strength and composition, general contribution to ecomomic developement and above all, its attitude towards social responsibilityes. Also to be considered in this chapter is an overview of some of the major problems facing the bank in the recent past.

Infact, we would observe in this chapter that it is the Bank's service commitment "to put a smile on the face of every customer"

3.2 HISTORICAL TRENDS IN FIRST BANK OF NIGERIA PLC

First Bank of Nigeria PLC commenced banking operations in Nigeria in 1894, after its incorporation as a limited liability company in London on March 31st of the same year. In the early days due to its rapid growth, the British colonial government also gave the bank the additional responsibility of performing the traditional roles of a central bank in the West African sub-region

---

10jo, A.J. (1990) "Monetary Policy and Competition for Deposits", First Bank Quarterly Review, March, 199 (PP.1-18).

With a paid up capital of 30,000 pound sterling, the bar increased its volume of business after it had absorbed it predecessor, the African Banking corporation, which was establishe earlier in 1892. The Banks name has been changed on a mumber o occassions as a result of significant events marking its lon history of over 100 years. The name was first changed from the Bank of British west Africa, the name at incorporation, to Bank of Wes Africa Limited in 1957. This followed the struggle for independence which began in the 1950s. It was again changed in 1965 to Standar Bank of West Africa Limited, as a result of the merger with the Standard Bank Limited of the United Kingdom in 1965. In complaince with the companies Decree of 1968, the Bank was incorporated in Nigeria in 1969 as Standard Bank of Nigeria Limited. With the commencement of the indigenisation programme of the Federal Government in 1972, the federal government acquired a 36.1 percent equity interest in the Bank while it also allowed other local investors to take up 12.9 percent, The majority 51 percent was held by Standard chartered bank Limited which resulted from a merger between Standard Bank Limited and the Chartered Bank (both in the United Kingdom). By 1979, the local interest in the bank increased to 62 percent following further dilution of Standard Chartered Bank's shareholding. The Banks name was changed in the same year to First Bank of Nigeria Limited with the shares being publicly quoted on the Nigerian stock Exchange. Following the promugation of the Companies and Allied Matters Act cap Laws of the federation of Nigeria 1990, and in compliance with the requirements of section 29 thereof, the Bank's name was changed to First Bank of Nigeria PLC.

In 1994, Standard Chartered Africa PLC began the process of divestment from the Bank following its new corporate policy of divesting from non-core activities and focusing on its core international businesses. Standard Chartered Africa PLC offered 120, 901, 195 sheres to the Nigerian public to reduce its shareholding to 9.9%. The equity holding of Nigerians at the

conclusion of the offer for sale therefore rose to 90.1%. In 1996 Standard Africa PLC offered its remaining shares of 66,576,807 to the Nigerian public and thereby fully divested from the Bank. cooperation agreement currently exist between the Bank and Standard Chartered Bank PLC.

The Bank is one of the biggest players in the retail banking business in Nigeria. It provides its numerous customers across th country with full range of commercial banking services including but not limited to, current savings and deposit accounts, loans an overdrafts, provision of international banking services, export credit and financial advisory services. In addition to the strengt derived from its financial base, the bank has 295 branches across Nigeria which is the largest number in the industry. With thi mumber, it has been able to establish its presence in every majo town and local government area across the country. It also has branch in the city of London. The Bank through the establishment o FBN (merchant Bankers) LImited as its subsidiary, Provides a ful range of merchant banking services to its numerous customers.

The bank has experienced phenomenal growth over the years With shareholders funds of N99 million in 1980, which in 1992 rose to about N986 million, the Bank had total shareholders funds o about N6.6billion as at 31 December, 1996. The Banks total asse base also rose from about N17 billion in 1992 to about N77 billio as at 31 December, 1996.

When the bank began operations in 1894, it had a staff of si comprising three Europeans and three Africans. Its staff strengt had increased and as at 30th June, 1997 the Bank had a total o 10778 employees, 4,148 of whom were senior and management staff.

The Bank considers its personnel as its greatest asset an therefore lays strong emphasis on training. Thus it operates moder and up-to-date training complexes in Lagos and other cities in th country to provide regular training for its staff in addition t sending them for off-shore courses. The Bank operates a non contributory pension scheme managed by a Board of trustees whic

KASHIM IBRAHIM

pays benefits to retired staff.

The Bank has over the years continually reviewed it organisational structure and corporate entity in line with th changing enviromental needs. For example, from 1985, decentralised organisational structure was introduced. This ha regularly been fine-tuned and by 1992, a major re-organisatio which still retained the basic principle of decentralisation wa introduced. The new structure has improved operational effecienc especially in the areas of treasury management, and internationa and corporate banking and has enable the Bank to respond speedil to changing market opportunities.

The bank has maintained its leadership in financing longter development of the economy which started in 1914 with a long-ter loan to the colonial government. It today boast of a diversifie loan portfolio and credit facilities to various sectors of th economy. The banks rural banking record is unmatched by any other bank while its agricultural credit facilities through communit farming loan scheme has given peasant farmers tremendous access to badly needed bank credit. For many years the Bank came first at th CBNs farmers merit Award. The Bank have also for many times won the Nigerian stock Exchange's (NSE), merit Award[20].

IN september, 1997, the bank offer for sale new issue of 200,000,000 ordinary shares of 50K each at an offer price of N10.5 per share. The proceeds of the offer is expected to be invested in leading edge technology to enhance the banks product delivery capability and finance the establishment of new branches so as not to jeopardise its expanding clientele as a result of the on going

[20]Economic Research Unit, Frist Bank of Nigeria Plc, Lagos "1992 Annual Report.

flight to safety in the Banking industry.

The Bank is very much alert to its social responsibilities. I continous to indentify with and to contribute generously to worth social, philantropic, cultural, educational and sporting events. I 1994, the Bank marked its centenary anniversary as the First ban to be established in Nigeria.

3.3 ORGANISATIONAL STRUCTURE

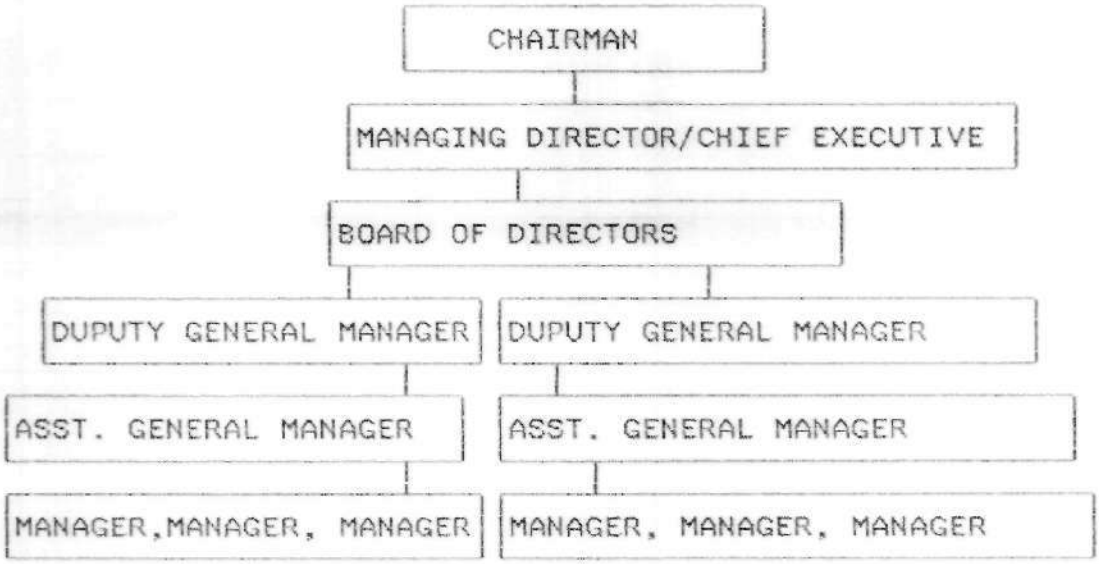
The organisational structure of the First Bank of Nigeria PL have over the years been reviewed continually in order to cope wi the impacts of change created by enviromental forces as well as t allow for internal administrative convinience and controls.

The perculiarity of the hierachical arrangement in terms o subordinate versus superior relationship is that, in FBN PLC, t post of the General manager appears and goes along the line a occassions demand using suitable mechanisms. The operations of t bank presently are managed through the following administrativ directorates, each of which is headed by an Executive Director;

i. Directorate of corporate Resources
ii. Directorate of Lagos Banking operations
iii. Directorate of state Banking operations
iv. Directorate of Finance and International Banking
v. Directorate of corporate finance and Information technolog
vi. Inspection
vii. Lagal and company secretariat

The general policy trust of the Bank is determined by a Boa of 15 directors all of whom are Nigerians

FIRST BANK OF NIGERIA PLC
ORGANISATIONAL CHART



Source: First Bank of Nigeria PLC, Research Unit, Lagos

3.4 SOME MAJOR PROBLEMS OF FIRST BANK OF NIGERIA PLC.

It is a well known fact that at a point in history success outdate the very behaviour that achieves it. The proverbial expression which says "nothing succeed like success" also hold true. However, there is no sustainable success that can be achieved on a "platter of gold".No organisation can pretend to be immune completely from problems in a dynamic business environment. First Bank of Nigeria PLC is not an exception in this respect. While some of the problems are exegenous and beyound the internal control mechanisms of the Bank, others can be manipulated internally. This problems include the following:

i. <u>Bad Debts.</u>

This is one of the serious problems of the organisation. The high risk associated with the Banks lending portfolio has been altributed to the general trend of capacity under- utilization in the manufacturing and agricultural sectors as well as lack of financial discipline on the part of Nigerian businessmen and institutional investors. The depreciation in the value of the nair

makes interest rates to be high while at the same time rea interest rates are low. The costs of investments are thus sometime higher than the returms on investment in real terms. This explain why the default risk is higher in recent times. For example, i 1992 provision for bad and doubtful accounts amounted to N86.51 million while in 1996 the figure increased to N69.143 million.

ii. Macro-economic instability recession and policy induce shocks

First bank of Nigeria is not operating in a vaccum. It i operating within the enclave of a financial structure and within a economic system, properly governed by institutional and legislative policy instruments towards achieving macro-ecomomic abjectives. I follows that, whenever there are changes in both institutional an legislative policy measures,there go along way in creating a deman for corresponding structure and strategy for the Bank. In the sam vein, the recession in the economy has directly or indirectl affected the overall performance of the Bank[21]

iii. Insider abuse and unprofessional conduct

This is the use of previlleged information or positions t perpetrate vices that are either against the law of the land (eg fraud) or unacceptable in the code of conduct of the bankin profession. Although frauds like defalcation can hardly b eliminated in modern banking due to the declining intergrity o employees and their general "lost" for quick riches.

"The increase in fraud is also occassioned by the proportionat increase in the level of growth in the financial system "said Mr H.A.P. Garba an FBN staff.

---

[21]Ojo A.J. (1976) The Nigerian Financial System, University Wales Press, Cardiff, 1976.

iv. Non-profitable Branches.

The proliferation of branches in FBN PLC is meant to enable grass root banking and thus a broader customer base[22]. However certain branches only exist because of the subsidy allowed them ie, they are non-profitable and are maintained irrespective o their low commercial viability. Consequently, most of them are operated at a loss. The case of the branch in Naka, Benue state i a notable example. It may be recalled that FBN PLC has 295 branches across the country.

These teaming problems of FBN PLC may not be exhausted here. However, in whatever form the problems manifest themselves, th ability of the company to face these challenges and convert ther into opportunities is what it takes to have a strong managemen team. So rather than using them as scapgoats, these problems should be properly addressed by management and converted int opportunities using appropriate machanisms as may be desired from time to time.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 INTRODUCTION

This chapter contains presentation and analysis of data relevant to this study. An opinion pool of target respondents is presented, classified and analysis made to reflect varying shades of opinion or viewpoints as expressed by respondents from the questionnaire administered to them by the researcher. These questions and responses are matched accordingly and tabulated for easy comprehension.

The chapter qually highlights the consistency or otherwise of findings with the survey of authors opinions in chapter two, hence, creating the platform upon which the hypothesis advanced in this research is proved.

4.2.1 PRESENTATION AND ANALYSIS OF DATA

In this section, the opinions of respondents are tabulated and classified using the percentage method to analyse the different shades of opinion from the respondents. For ease of comprehension, each table contains the respondents views for each question. The aggregate response for each option or viewpoint is expressed as a percentage response of the sum of those respondents who share a similar viewpoint for any specific question advanced in the questionnaire and interview schedule.

Technically, the first five questions in the questionnaire used for this study are designed to probe the rationality or otherwise of certain major exchange rate induced macro economic policy objectives. On the other hand, the next five questions seek to make inferences as regards the relationship between exchange

rate mechanisms and the performance of commercial banks in general and First Bank of Nigeria PLC in particular.

QUESTION 1.

In 'real terms' did Nigeria gain from the devaluation of the Naira?

Options	No. of Respondents	Percentage
No	85	85%
Yes	15	15%
Total	100	100%

TABLE 1

Source: Fieldwork, October, 1998.

From the aggreagte response presented above, 85% of managemen staff of FBN PLC attest that Nigeria in real terms did not gair from devaluation of the Naira while 15% of the sampled respondent held the opinion that Nigeria did gain from the exercise.

QUESTION 2

By using the parallel market rates as reference for fixin official foreign exchange rates (FEM rates), the Government wa indirectly legitimizing the parallel market.

Options	Respondents	Percentages
True	70	70%
False	30	30%
Total	100	100%

TABLE II

Source: Fieldwork, October, 1998

In question 2 above, one may observe from the table II tha seventy percent of the respondents hold the view that Governmen indirectly legitimized the parallel market exchange rates sinc

there was a high correlation between these rates and the official rates at FEM. However, 30% of the respondents believe that the measure was not meant to legalise parallel market but to narrow the gap in the rates between the two markets.

QUESTION 3

Was exchange rate liberalization capable of guaranteeing the efficient functioning of the FEM?

Options	Respondents	Percentages
YES	13	13%
No	87	87%
Total	100	100%

TABLE III

Source: Fieldwork, October, 1998

QUESTION 4
If No, why?

Options	Respondents	Percentages
Due to to huge arbitrage	20	20%
Iadequate supply of forex	60	60%
Inconsistency in macro-economic policy objectives/pursuits.	20	20%
Total	100	100%

TABLE 1V
Source: Fieldwork, October, 1998.

In tables III and IV above, the former has shown that 87% of the respondents favoured the option that a deregulated exchange rate regime could not have produced an efficient FEM. While advancing reasons to support this assertion, 60% of the respondents felt that inadequate supply of forex was responsible

for that because in an efficient market, the demand for and supply of forex need not be in equlibrium. Yet, others felt that the system would have worked if there was no arbitrage or inconsistencies in macro-economic policy objectives/pursuits. This category of people constituted 20% of the respondents respectively.

QUESTION 5

What do you think is the relationship between exchange rate mechanisms and the development of the non-oil sector in Nigeria?

Options	Respondents	Percentages
Perfectly positively correlated	30	30%
Less than perfectly positive correlation	62	62%
Negatively correlated	08	8%
Total	100	100%

TABLE V
Source: Fieldwork, October, 1998

As indicated in table IV above, only 30% of the respondents agreed that exchange rates are perfectly positively correlated with the development of the non-oil sector. 62% of the respondents are of the view that a less than perfectly positive correlation exist between exchange rate mechanisms and the development of the non-oil sector while only 8% of the respondents supports the negativity correlation effect of exchange rate mechanisms on the non-oil sector.

4.2.2 IMPACTS OF EXCHANGE RATE MECHANISMS ON FIRST BANK OF NIGERIA PLC.

In a bid to correct the imbalances in the external sector and stabilise the naira exchange rate, government have over the years employed various measures ranging from outright devaluation and use of direct approach to monetary and credit control through deregulation of interest and exchange rates to other macro-economic policies that ensured stiff competition and a vibrant banking system. These exchange rate induced policy pursuits had both positive and negative impacts on FBN PLC. Questions 6-10 are herewith covered and the responses to them are classified in terms of the aggregate response from the respondents on each question given the options available in the closed-ended questions.

QUESTION 6

What was the major effect of the frequent use of stabilization securities to "mop up" excess liquidity in the system on FBN PLC.

Options	Respondents	Percentages
Planning became riskier	10	10%
Credit growth hampered	20	20%
All of the above	70	70%
Total	100	100%

TABLE VI **Source:** Fieldwork, October, 1998

Table VI above depitch that 70% of the respondents held the opinion that the use of stabilization securities as an istrument of direct monetary and credit control to control domestic

inflation and thus naira exchange rate had adverse effect on credit growth and made planning of the bank's portfolios difficult and riskier. Nevertheless 10% and 20% of the respondents felt the measures only made planning riskier and hampered credit growth respectively.

QUESTION 7

Did the establishment of the Bureaux de change in 1989 pose a serious challenge to FBN PLC in terms of annual earnings on forex transactions?

Options	Respondents	Percentages
Yes	30	30
No	70	70
Total	100	100%

TABLE VII

Source: Fieldwork, October, 1998.

On the above table, it can be observed that 70% of the respondents share the view that the establishment of the Bureaux de change has posed no serious challenge to FBN PLC in terms of annual earnings on forex transactions. This is because the bulk of their clients are manufacturers or industrialists who has huge demand for forex to either travel aborad to effect transactions or to import raw materials and spare parts for worn out machines. However, about 30% of the respondents felt FBN PLC was affected since the Bureaux de change seemed to be receiving special "blessings" from government regulations.

QUESTION 8

What were the immediate consequences of the frequent changes in the guidelines by the CBN in respect to foreign exchange allocative system and procedures?

Options	Respondents	Percentages
Higher "overheads	20	20
Higher uncertainty in treasury management	54	54
Higher need for contingency plans	26	26
Total	100	100%

TABLE VII

Source: Fieldwork, October, 1998.

In Table VIII above, 54% of the respondents opined that the immediate consequences of irregularity in policy framework by the CBN was that it made the art of managing the treasury of FBN Plc more difficult due to the higher uncertainty that clouded the policy framework. Also about 30% of the respondents felt the immediate consequence was increase in overhead costs resulting from administrative inconveniences and "shocks" or shortfalls. Yet, 20% of the respondents attributed it to an ever growing need for contingency plans since long term planning was becoming very risky.

QUESTION 9

In actual sense, what has been the determining factor for exchange rates in Nigeria since september, 1986?

Options	Respondents	Percentages
Demand and Supply situations at the FEM	36	36
Administratively fixed	12	12
Behaviour in the parralel market	08	08
Degree of speculative demand/ activities	04	04
Level of arbitrage	02	02
All of the above	40	40
Total	100	100%

TABLE IX

Source: Fieldwork, October, 1998

From Table IX above, one can observe that 36% of the respondents held the view that the demand for and sypply of forex at the FEM in actual sense has been the determining factor for exchange rates movement in Nigeria since September, 1986. Also, others felt the determining factors were: Government policy to peg it, behaviour in the parallel market, the degree of speculative demand/activities, and the level of arbitrage by forex "hawkers". Those in these categories constituted 12%, 8%, 4% and 2% respectively. Yet, there were others who held the view that all the underlisted factors are responsible for exchange rate determination since 1986. This category of respondents constitute 40% of the total number of respondents.

QUESTION 10

What was the implication of the adoption of the dual exchange rate system on FBN Plc earning in 1995?

Options	Respondents	Percentag
"Exceptional" income gained through conversion ration of overseas bank's balances	100	100
Exchange difference reserve account was negative	-	-
Total	100	1000%

TABLE X

Source: Fieldwork, October, 1998.

From the Table X above, all the respondents animously agreed that there was no shortfall in the exchange difference reserve account in 1995 when the dual exchange rate system was adopted. All the respondents attest the fact that there was "exceptional" income which represented the gain arising in 1995 from the conversion of the Bank's balances held with banks outside Nigeria from N22/$ to approximately N82/$ which amounted to about N.957billion.

4.3.1 FINDINGS

Going by the analysis of data presented above in 4.3.1 and 4.3.2 respectively, the researcher has come up with findings that are relatively consistent with the survey of authors opinions in chapter two on the one hand. On the other hand, the findings constitutes a bedrock for proving the hypothesis advanced for this study.

From the questionnaire administered and the interview schedule conducted with selected management staff of FBN Plc, all of them responded well. However, most of them did not favour some of the policy thrust which the government put in

place to complement the "deregulation" stance especially the exchange rate induced policies. According to most of the bankers, the frequent changes in policy thrust with respect to exchange rates/foreign exchange transactions ushered in a high degree of inconsistency which was detrimental to long-term planning and treasury management, hence, the growing need for contingency approach to planning in Banks.

From the findings of this study, the growth in the activities of the black marketers could be attributed to government policy which indirectly confers some legitimacy to them by using the black market rates as reference rates for fixing the official rates at the Autonomous Foreign Exchange Market. hence, speculative bidding was encncouraged by the action of arbitragers due to the existence of these two markets that both gained the recognition of government. However, the establishment of the Bureaux de Change did not pose a serious threat to the earnings of FBN Plc from forex transactions because most of its demands for foreign exchange was to channel to the manufacturing sector whose demand constitute up to 65% of the total demand for forex.

It was evident that the devaluation of the naira as a policy stance did not yield the expected dividends credited to it. This have been depitched in table 1 above. The frequent use of stabisization securities to mop up excess liquidity in the financial system was found to have hampered the credit growth of FBN Plc apart for making credit and other forms of planning more riskier as depitched in table IV above.

The study have also found out that in line with the survey

of authors opinions in chapter two, exchange rates in Nigeria since 1986 has been determined through the interplay of demand and supply situations at the FEM, the developments in the parallel market, the degree of speculative activities/demands as well as the level of arbitrage. It has also been administratively fixed as situations permits and in line with developmental aspirations of the country. Also found was the relationship between exchange rate mechanisms and the development of the non-oil sector in Nigeria.

The dual exchange rate policy adopted in 1995 it was evident brought in "exceptional" income to FBN Plc from the conversion of the bank's balances held with banks outside Nigeria from N22 per US$ to approximately N82 per US$. The management considers this exceptional because of its size and because they do not expect it to recur.

4.3.2 PROOF OF HYPOTHESIS

From the onset, some theoretical assumptions (ie hypothesis) were advanced to guide the conduct of this study. It suffice therefore, to align the findings of the study against these assumptions in order to validate the study while creating a framework upon which further researches on the subject matter may be carried out with relative ease.

These hypothesis are proved as follows:-

i. Exchange rate under a liberalised system is more economically feasible and is a key to ensuring a "realistic" naira exchange rate.

To prove the above hypothesis (i), refer to Table III, IV and IX above. This hypothesis is not accepted because in Table

III, 87% of the respondents are of the opinion that exchange rate liberalisation was not capable of guaranteeing the efficient function of the FEM. The reasons advanced to support this position are found in Tables IV and IX, namely the high level of arbitrage, the gross inadequacy in forex supply at FEM (ie the supply gap), the degree of speculative demand as well as inconsistencies in macro-economic policy objectives/pursuits.

ii. Investors, lenders and borrowers are subject to exchange rate risk.

Hypothesis ii above is accepted because the degree of predictability of trends in exchange rate mechanisms is very crucial for decision making for both investors, lenders and borrowers. Variations in exchange rates therefore increases their risks which may manifest in the form of higher business risk, interest rate risk, market risk and purchasing power risk as the case may be. Tables VIII and X above have shown that inconsistencies in exchage rate induced policy objectives/procedures has made treasury management more difficult while increasing overhead costs. However, in table X an "exceptionally" huge income was gained in 1995 fiscal year by FBN Plc form the conversion of the Bank's balances held with banks outside Nigeria from N22 per US$ to approximately N82 per US$ following the introduction of the dual exchange rate system in 1995. The risk-return trade off can therefore be justified and hence it constitute the acceptance criteria for the above hypothesis.

iii. Devaluation of the naira exchange rate would provide sufficient incentive to exports and sufficient

disincentive to imports and capiral flight.

The above hypothesis iii is not accepted because table 1 have shown that 85% of the respondents held that in "real terms" NIgeria has not gained from devaluation of the Naira. It may be observed that devaluation of the naira was merely a "shot in the arm", as reduction in external prices was only temporally due to the increased costs of essential imports which reflected itself in increased domestic prices thus nullifying some, if not all, of the previous advantages of devaluation. To support this position, table IX have shown that 36% of the respondents held the view that one actual determining factor for the naira exchange rates is the demand for and supply of Foreign exchange at the FEM. If this holds true, then, internal economic health is the great preventive against the external virus of currency devaluation because both the demand for and supply of foreign exchange is a function of the economic soundness of Nigeria. You can not earn enough forex to supply at the FEM if the contry has a very low Gross National Product. A high GNP can be achieved more easily given a high elasticity of demand for our products in international markets. Conversely, you can not increase demand for forex at the FEM when the ultimate demand is very low due to low incomes and thus low purchasing power in the domestic economy.

iv. There is a direct relationship between exchange rate and the development of the non-oil sector.

The above hypothesis (iv) is not accepted because table v shows that 62% of the respondents held the view that the relationship between exchange rate and the development of the

non-oil sector is less than perfectly positively correlated - ie, the correlation is less than 1 but greater that zero. Only 30% of the respondents are in support of a perfectly positive correlation ie correlation been equal to one (1). It implies therefore that a percentage change in exchange rate may not necessarily lead to a proportinate change in developments in the non-oil sector of the Nigerian economy.

So, technically, the findings of the research have attempted to validate the hypothesis advanced for this study while laying down the foundation upon which conclusions and recommendations would be drawn in the subsequent chapter.

CHAPTER FIVE

SUMMARY, RECOMMENDATIONS AND CONCLUSION

5.1 SUMMARY

This study borders on impacts of exchange rate mechanisms on First Bank of Nigeria Plc. It pays more attention however, on some major macro-economic policy framework relating to developments in the extrenal sector particularly with respect to exchange rates and the impacts of such developments on First Bank of Nigeria Plc's (FBN PLC) overall performances. Generally speaking, the study attempts to broaden our perspective on how exchange rates are determined and the risks associated with exchange rate volitality.

A general introduction to the study is presented in chapter one where the research problem is clearly stated and the purpose and significance of the study outlined. While raising some hypothesis, the study also defined certain operational terms and drew out the scope and limitations as well as sources of data collection in the hope to give an over view of the structure of the work. In chapter two, a review of past researches by a survey of authors is presented within a given conceptual framework relevant to this study. Under the review of related literature, the evolving structure of the Nigerian financial system is presented as well as the determination of exchange rates and the role of commercial banks in exchange rate determination. Also under review is exchange rate administration during the Structural Adjustment Programme (SAP), particularly exchage rate "liberalization" under the Foreign

Exchange Market (FEM) with the activities of the Bureaux de change and Black Marketeers in force. Causes of persistent depriciation of the naira exchange rate were also examined as well as the impacts of exchange rate mechanisms on commercial banks. The study lastly reviewed some recent trends in exchange rate mechanisms especially with respect to Nigeria.

Chapter three is a historical profile of First bank of Nigeria Plc with particular attention to some of the major evolving structures ranging from ownership structure, capitalization, asset base, earnings and staffing to organisation structure. some of the problems of the Bank were also highlighted.

In chapter four, contain data presentation and analysis of findings. Chapter five comprises of the Summary, Recommendations and Conclusions. The symmary highljghts the major issues in the study concisely while recommendations are prescribed in the hope to balance the survey of authors opinions in chapter two against the research findings in chapter four.

First Bank of Nigeria PLC being the pioneer bank in the country have contributed a lot to the mobilization and chanelling of funds to the most productive uses thus providing liquidity in the system. since exchange rates are linked with domestic prices, monetary authorities are concerned with measures that would ensure a realistic exchange rate for the naira. Nevertheless,these teaming macro-economic policy measures have on many occassions failed to produce the expected dividends credited to them and appears as if government have been inconsistent on the ultimate exchange rate induced policies that will guruantee the stability of the naira. As a consequence, a lot of risks are borne by investors, lenders and

borrowers with a correspondingly high expected returns. The impacts of exchange rate mechanisms on FBN PLC can not therefore be over-emphasized.

5.2 RECOMMENDATIONS

Having reconciled the findings of this study with the survey of authors opinion on the subject matter the researcher wish to put forward some recommendations with the expectation that when implemented, a lot of challenges and problems stated in this study shall be turned into opportunities, thus, going a long way to solve some exchange rate related problems. These recommendations are as follows:-

1. Government should no longer devalue the naira at least in the immediate future but rather concentrate more energy to revitalize the industrial sector towards greater output.
2. The establishment of the solid mineral ministry is a step in the right direction because adequate foreign exchange supply at the FEM can only be realised if many sources of generating these forex are utilised/tapped. Since our economy is resilient, there is need for aggressive export promotion, and more contribution from the non-oil sector to our foreign exchange earnings in order to boost the supply side and nullify demand pressures.
3. Fiscal discipline should be our watch work. We require leaders of high integrity at all levels and a disciplined citizenry with good values. If government channel the scarce forex to the most productive uses, in the long run our capacity to generate forex would be enhanced. Conversely, authorised dealers in foreign exchange should abstain from speculative

demand and arbitrage so as to bridge the gap between the demand for and supply of foreigh exchange at the Autonomous Foreign Exchange Market (AFEM).

4. The dual exchange rates (ie the official and the AFEM rates) should be harmonised so as to make do with the activities of arbitragers. The IMF have already frowned at this policy of dual exchange rates for the naira.

5. To discourage the growing influence of the parallel market rates, government should never use the rates as a reference for fixing either the official or the Autonomous Foreign Exchange Market rates, but instead, decree it illegal. In addition, punishment should be clearly spelt out for forex "hawkers" or arbitragers and even those who patronise them (because they are saboteurs).

6. In line with our developmental aspirations and capabilities, FEM's operational efficiency, dynamism, depth and width may be enhanced through the adoption of some exchange rate policy induced measures, tools and strategies such as hedging, forward contracts and swaps.

7. There is also need for a more effective demand management policy through the adoption of a more appropriate fiscal and monetary policies. The use of indirect rather than direct measures for monetary and credit control shall be a welcome development which will complement the advantages already achieved with the abolition of the stringent exchange controls in 1986.

It is expected that if these recommendaations are given due

consideration by both the private and public sector they may help in solving some of the exchange rate related problems in Nigeria.

5.3 CONCLUSION

Trends in exchange rate mechanisms have always attracted the attention of every successive government in Nigeria and in recent times have been a pivot within which macro-economic policies revolve. This is because exchange rates are directly linked to domestic prices and the disadvantage of a high inflation rates resulting from a low exchange value for the naira has to be balanced against the advantage of a growth in the export subsector resulting from lower external value for our exports. Consequently, the abolition of stringent exchange controls in 1986 and the subsequent devaluation and deregulation of interest and exchage rates has succeeded only in addressing the problems of over-valuation of the naira. Developments in the non-oil sector is still low and the rate of inflation still high. Exchange rate volitality had persisted until the dual exchange rates system was introduced in 1995. Presently, relative stability in AFEM rates is guruanteed but there is no commensurate growth in the export sector despite the cheapening of the naira relative to other currencies. This implies therefore that the demand elasticity for our exports is low in the international market. In addition, the expansionary fiscal and monetary developments is inconsistent with the overall macro-economic policy stance.

Despite some far reaching policy measures embarked upon by government in 1992, 1994 and 1995 to sanitise the system, the

unification of the official and autonomous foreign exchange rates, if carried out, will help to even -out most of the distortions in the external sector. This is because it is quite possible that a fixed rate system and complete exchange rate flexibility will both work better than a compromise between the two. Also if government should rely more on the indirect approach to monetary and credit control the FBN PLC will have a cause to smile soonest.

BIBLOGRAPHY

1. Adekanye, F. (1986) The Elements of Banking in Nigeria. 3rd edition, F&A publishers, 176 Awolowo Road Ikoyi, Lagos.

2. Ahmed, A. (1992) "The State of the Nigerian Economy and the policy options". Bullion, vol.17, No. 5, November.

3. Agene, E.C. (1991). Foreign Exchange and International Trade in Nigeria, Gene Publications, Lagos.

4. Ball R.J, Burns T., Laury J.S.E (1977). "The Role of Exchaenge Rate changes in Balance-of-payments: The United Kingdom case" The Economic Journal, Vol.87, March.

5. Bullion (1993). "Budget of Transition", CBN Publications, Vol.17 No.5, Jan-March, 1993.

6. Bullion, (1975). "budget of Economic Growth and Development",CBN Publications, Vol.21, No.1, Jan-March, 1997.

7. Economic Research unit, First Bank of Nigeria PLC (1992). "Anual Report and Accounts".

8. Economic Research Unit, First Bank of Nigeria PLC (1996). "Anual Report and Accounts".

9. Evith H.E (1996) A Manual of Foreign Exchange 6th Edition, Pitman Publishig company, Newyork.

10. Franklin R.R (1978) International trade and Investment. the Editio, South western Publishing company, Gincinnati, Ohio.

11 Friedman M. (1953) "The Case For Flexible Exchange Rates" In Eassays in Positive Economics, pp.157-203. Chicago University of Chicago Press.

12. Gustav C. (1918) "Money and Foreign Exchange After 1994". Economic Journal, March.

13. Haberler G. (1976). "Review of Frankel and Johnson (1976)" Journal of Economic Literature, Vol.14 December.

14. Johnson, H.G. (1976) "The Monetary Theory and Balance-of-Payments Policies". Chapter II Frankel and Johnson (1976).

15. Johnson <P.D> (1976) "Money and Economic Activity in the United Kingdom, 1880-1970. Journal of Political Economy, Vol.84,October

16. Kaldor, N. (1971) "Conflicts in National Objectives". Economic Journal, March, Vol. 81, pp 1-16

17. Kern, D. (1982) "The International Currency Markets" Journal of Institute of Bankers, February, pp.6-9.

18. Mundell, R.A. (1960) "The Monetary Dynamics of International Adjustment Undeer Fixed and Flexible Exchange Rates". Quarterly Journal of Economics, Vol. 74 9May), pp. 227-57. Reprinted in Reviewed form as chapter II of R.M. Mundell's International Economics (Macmillan, Newyork, 1968).

19. Newswatch Magazine "The Crash of the Naira". Newswatch Publications, March, 1993.

20. Ntekop, T.J. (1992) "Foreign Exchange Market in Nigeria" Bullion, VOl. 16, No. 3, CBN Publications, Lagos

21. Okigbo, P.N.C. (1981) Nigeria's Financial System. Longman publications

22. Ojo, A.T. (1990) "Monetary Policy and Competition for Deposits". First Bank of Nigeria Plc, Quarterly Review, March, 1990.

23. Owolabi, E. A. (1992) "Exchange Rate Administration Under The Structural Adjustment Programme" Bullion, Vol. 16, No. 2. CBN publications, Lagos.

24. Resear Department, CBN (1979). "Twenty Years of Central Banking in Nigeria". CBN publications, Lagos.

25. Rodriguez, R.M. and Carter, E.E. (1979) International Financial management Prentice-hall, Inc. London

26. Rue, L.W. and Byars, L.L. (1983) Management: Theory and Applications 3rd Edition, Richard D.I., Inc. USA

27. UBA, Monthly Business and Economic Digest (1992) "Naira Exchange Rate: Recent Developments" Vol. 14, No. 8, March

28. UBA, Monthly Business and Economic Digest (1991) "CBN's Liquidity Mop-up and Monetary Policy in Nigeria" vol. 15. No. 16, June.

29. UBA Monthly Business and Economic Digest (1991) "Exchange Rate Liberalization: What impact on Non-oil Export Development in Nigeria". Vol. 18, No. 12, October

30. Vash, M.C. (1977) Money, Banking and International Trade 3rd Edition, Vikas publishing house, New Delhi.

APPENDIX I

RESEARCH QUESTIONNAIRE

I have the pleasure to present my research questionnaire foryuour response as contained herewith. It is the hope of the researcher that the information obtained shall be treated confidentially especially as the purpose of the research shall permit. These questions are aimed at probing into the existing literature about the subject matter in the hope to bringing out relevant facts and drawing conlcusion upon the consistency or otherwise of the research findings with the survey of authors opinion.

I therefore wish to solicit your much desired cooperation.

SECTION A: INSTRUCTIONS.

The questionnaire is closed-ended and the respondent is expected to choose only one option that he considers best answer for each question.

SECTION B: PERSONAL DATA

1. AGE BRACKET

A. 25-30 years, B. 31-40 years, C.40-50 years, D. 51-above

2. SEX: A. Male, B. Female

3. MARITAL STATUS: A. Married, B. Single

4. RANK/POSITION: A. Manager, B. Asst. General Manager, C. Deputy General manager, D. Executive Director, E. Managing Director

SECTION C: GENERAL QUESTIONS

1. In "real terms" did Nigeria gain from the devaluation of the Naira?

   A. No, B. Yes

2. By using the parallel market rates as reference for fixing official foreign exchange rates (FEM rates), the Government

was indirectly legitimizing the parallel market.

A. True, B. False

3. Was exchange rate liberalization capable of guruanteeing the efficient functioning of the FEM.

A. Yes, B. No

4. If above is "No", why?

A. Due to high arbitrage

B. Inadequate supply of forex at the FEM

C. Inconsistency in macro-economic policy objectives/ pursuits

5. What do you think is the relationship between exchange rate mechanisms and the development of the non-oil sector?

A. Perfectly positively correlated

B. Less than perfectly positively correlated

C. Negatively correlated

6. What was the major effect of the frequent use of stabilization securities to "mou-up" excess liquidity in the system on First Bank of Nigeria Plc?

A. Planning became riskier

B. Credit growth hampered

C. All of the above

7. Did the establishment of the Bureaux de change in 1989 pose a serious challenge to FBN Plc in terms of annual earnings on forex transactions.

A. Yes

B. No

8. What were the immediate consequences of the frequent changes in the guidelines by the Central Bank of Nigeria (CBN) in respect to foreign exchange allocative systems and procedures?

A. Higher overhead costs

B. Higher uncertainty in treasury management

C. Greater need for contingency planning

9. In actual sense what has been the determining factor for exchange rates in Nigeria since September, 1986?

A. Demand and supply situations at the FEM

B. Administratively fixed

C. Degree of speculative demand by authorised dealers

D. Level of arbitrage

E. All of the above.

10. What was the implication of the adoption of the dual exchange rate system on FBN Plc's earnings in 1995?

A. Exceptional income gained through a favourable conversion ratio of the Banks balances overseas.

B. Exchange difference reserve account was negative

Appendix B

Source: Central Bank of Nigeria, Research Unit, March, 1995