TITLE PAGE

THE EFFECTS OF COMPLETE DEREGULATION OF FOREIGN EXCHANGE MARKET ON BOTH FINANCIAL AND MANUFACTURING SECTORS OF NIGERIAN ECONOMY (1986-1993)

BY

KEHINDE ADETOLA BASHORUN

REG. NO. G90BA7130

INSTITUTE OF ADMINISTRATION
AHMADU BELLO UNIVERSITY
Z A R I A.

DECLARATION

15289

I hereby declare that this is an original work and a product of my research findings and that it has not been submitted elsewhere for a degree.

All references are dully acknowledged in the body of the work.

DISERTATION

This Research Project Report is submitted to the Institute of Administration in partial fulfilment of the requirements for the award of a Master's Degree in Business Administration.

Ahmadu Bello University

Kɑngo Campus, Zaria.

CERTIFICATION

This project report/Thesis/Dissertation entitled The Effects of Complete Deregulation of Foreign Exchange Market on Both Financial and Manufacturing Sectors of Nigerian Economy (1986-1993) by Kehinde Adetola Bashorun meets the regulations governing the award of the degree of MBA of Ahmadu Bello University, and its approved for its contribution to knowledge and literary presentation.

(Name and Signature)

M.N. MATIVENE ---------- Date:----------

Chairman, Supervisory Committee

(Name and Signature)

---------- Date:----------

Member, Supervisory Committee

(Name and Signature)

---------- Date:----------

Member, Supervisory Committee

(Name and Signature)

---------- Date: 14/1/03

Head of Department

(Name and Signature)

---------- Date: 16/04/02

Dean, Postgraduate School

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ABSTRACTS

The value of Naira continued to drop appreciably since 1986 when the government embarked on market economic reforms, especially the deregulation of Foreign Exchange System. Though, from time to time the policy makers have adjusted the mechanism for operating the market to make it more efficient through various techniques.

The complete deregulation of Foreign Exchange was adopted in 1992, in the continued search for an appropriate exchange for Naira. The significant effects of this major exchange rate reform package on financial and manufacturing sector were assessed.

The financial sector continued to withness a massive devaluation of Naira, closure of gap between the official and parallel market rates remained elusive of the policy makers, unacceptably high interest rate persisted, making Naira very more unstable. Also competition against parallel market was hampered as a result of too much documentary requirements and other restrictions of the CBN.

Furthermore, manufacturing sector experienced high cost of fund, accessibility to loanable fund was difficult, depressed demand of manufactured goods and continuous hike in prices by manufuturers.

To achieve exchange rate system stability, government should continue to encourage non-oil exports in order to boost supply of Forex through number of structures and incentives.

Manufacturers should be allowed to retain 100 percent of their export proceeds in forex. Government should encourage petro-chemical industry which is the source of raw materials supplies of manufacturers. Liquidation of terminally distressod financial institutions ordered and debt recovery and credit enforcement through the exercise of legal remedies should be reviewed to ensure that culprits are effectively brought to book.

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DEFINITIONS

Interest Rate: This is the pure rental value paid for the use of money or credit. It is often expressed as a percentage per annum.

Savings Deposit Rate: The Saving Deposit rate is the amount paid by banks for funds withdrawable after seven days' notice. This restriction is however seldomly applied.

Fixed Deposit Rate: When deposits are for fixed period of time, say, 90 or 180 days the interest rates paid are called Fixed deposits rates.

Minimum Rediscount Rate (MRR):

This refers to the amount that is charged by the CBN for lending to banks in the performance of its function of a lender of last resort. Minimum Rediscount Rate (MRR) also refers to the rate chaarged by CBN for discounting bills before maturity.

Prime Lending Rate (PLR):

This is the interest rate applied to loans made to customers with the highest credit rating. For each bank, this rate should also represent the minimum lending rate.

Maximum Lending Rate (MLR):

This refers to the rate charged by banks for lending to customers with a low credit rating.

Inter-Bank Interest Rate:

This is the rate that applied to transactions between banks mostly for overnight and short-term funds.

CHAPTER ONE

INTRODUCTION

Nigerian economy has undoubtedly undergone a transformation in the recent years particularly in both financial and manufacturing sectors since inception of the Structural Adjustment Programme (SAP) in 1986. Of all the policies initiated under SAP, the most far-reaching policy was the deregulation of foreign exchange market.

Before the advent of SAP, it had been argued that Naira was over-valued at an official rate of N1 was $1.63 in 1981 according to Thompton (1992). As a result of this Nigerian exports were too expensive to compete in the world markets, thus, many export industries were abandoned apart from oil while a Naira commanded an abundance of foreign currency in theory, foreign exchange (Forex) was difficult to obtain in practice. It became difficult for industries to procure their imported imputs due to lack of forex. This led to massive retrenchment, scarcity of essential commodities, under utilization of existing production capapcity and inflation.

The deregulation of Forex market made it easier for manufacturers (Users) to obtain Forex from

banks which were major buyers from the Central Bank of Nigeria (CBN). But this policy created a new set of problems for the economy as the value of Naira continued to depreciate against foreign currencies and also there was an observable wide disparty between the official and parallel market rates because CBN was the chief source of Forex. Also, only small amount of Forex was available for auction at the CBN, thus, the banks were not able to supply the manufacturing firms with adequate requirements of their forex needs.

Furthermore, banks persistently inflated the forex requirements of their clients, thus, became unpatriotic in their bidding at second-tier Foreign Exchange Market (SFEM), Foreign Exchange market (FEM) and Inter-bank Foreign Exhange market (IFEM). And they also diverted officially subsidised Forex obtained from CBN to parallel market. The manufacturing sector was not able to find Naira cover to buy its Forex requirements as Naira persistently depreciated against other foreign currencies. Expectedly, manufacturing Companies closed, those in operations cut down production. This led to once again drastic reductions in their staff strengths, low level of capacity, utilization.

The low level capaicity utilization was the greatest problem confronting the manufacturing sector, unfortunately, this sector of the Nigerian economy had not benefited much from economic policies by the government, instead government agencies and certain official were still perpetrating corruption and also managing the economy poorly. Under the same economic difficulties the Financial Sector recorded remarkable growth in terms of number of banks.

1.1 THE STATEMENT OF THE PROBLEM

The persistent instability of Forex market reflected in the wide disparity between the official and parallel market rates caused the policy makers to adopt a complete deregulation of Forex market on March 1992. This new system of Foreign Exchange trading was aimed to close the gap between the official and parallel market rates and allow the official rate of naira finds its value against the parallel market value. Also, to check the malpractices perpetuated by authorised dealers in forex expecially the banks which were channelling officially subsidied forex to the parallel market.

1.2 THE OBJECTIVES OF THE STUDY

The objectives of the study include:

i. To study the Forex market before the complete deregulation period (1986 - 1991).

ii. To determine the effects of the complete deregulation of the Forex Market on Financial Sector of the Nigerian economy. (1992-1993).

iii. To investigate the effect of complete deregulation of Forex Market on the manufacturing sector of Nigerian economy.

1.3 RESEARCH METHODOLOGY

The comparative approach was adopted in order to ease the process of studying the effects of complete deregulation of forex market on financial and manfacturing sectors. Thus, the effects of exchange rate policies under partial deregulations of forex market from period 1986-1991 was compared with effects experienced by those sectors when the forex market was completely deregulated within period March, 1992 - 1993.

Both primary and secondary data were used, sources of primary data were First City Merchant Bank of Nigeria (FMBN) Eko International Bank (EIB) and SCOA Motors. Strastified random sampling was adopted in selection of the two banks. The technique employed in collection of the primary data was oral interview. Sources of secondary data include, CBN Economic and

Financial Review, Bullion books unpublished theses, CBN Annual Reports and Statements of Accounts and various Newspapers.

The period (1986 - 1993) was chosen for the study. Data were presented in bar chart; tabular form and graphic form and stastically analysed.

The study was confronted with problem of incomplete and inconsistent data in the use of secondary data. But to ensure possible accurate result, reliance was placed on publications which data appeared to be least inconsistent. Also, from persons in bank unwilling to disclose all necessary information especially, the forex and interest rates.

There was difficulty of isolating the effects of forex and exchange deregulation (that is when exchange rate is allowed to float or market determined) from these effects arising from other policies such as monetary, fiscal and sectorial polcies.

THE SIGNIFICANT OF STUDY

The significance of this study has in identifying or analysing the desirable and undesirable consequencies, brought about by the complete deregulation of the Forex Market in the Financial and manufacturing sector of Nigerian economy.

CHAPTER TWO

LITERATURE REVIEW

2.1 Definations of Foreign Exchange Market and Exchange Rate

The foreign Exchange Market is a market for sale and purchase of foreign currencies while exchange rate is defined as the price of one currency in terms of the other. That is, the exchange rate of a country is the price of its domestic currency vis a vis other currencies. It can also be described as a country unit of domestic currency per units of foreign currency. Hence the units of Naira to a given unit of U.S. dollars Pound Sterling or any trade country. The exchange rate may either be set by the government through intervention or defermined by market forces.

2.2 Types of Exchange Rate Policies

Over the years, the exchange rate has emerged as a potent policy instrument in economic management of its immersed influence on economic activities, in order to achieve meaningful development, contries have had to adopt exhange rate that would ensure favourable balanced of payments position, eliminate any possible distortions to relative prices and ensure rational allocation of resources between production and consumption.

The type of exchange rate system to be adopted

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is very important as it determines the type of foreign exchange market a country wants to operate. Thus, the apex regulator authority of the Financial System in any country, in its efforts to maintain the value of domestic currency vis a vis foreign currencies and also to maintain the value of country's external reserves may recommend to its government to adopt any of the following exhange rate systems:

i. The regidly fixed exchange rate.

ii. Free floating exchange rate.

iii. The variants of these extreme systems which include:

(a) Managed floating exchange rate system which is the variant of free floating exchange rate system.

(b) Ajustable pęy and crawling peg system which are variants of fixed exchange rate system.

2.2.1 Fixed Exchange Rate System

Under the fixed rate, the exchange rate of a currency is fixed in terms of some common units of Gold or any foreign currency. For example, prior to 1914 and for a period after the first World war, in the international economics, each country currency had a fixed value in terms of Gold. Gold was the numeraire. Also from Nigerian experience, for a period between April

1974 to 1978, exchange rate of naira was fixed in terms of dollar and sterling.

The Adjustable peg and the crawling peg systems are variants of fixed exchange rates under the adjustable peg system, members of International Monetary Fund (IMF) were allowed to fix but adjust their exchange rates from time to time in the event of a fundamental disequilibrium, within, a band of one per cent, either side of an agreed per value. Most members of IMF suggested that, there should be parity of exchange but the parity itself would be allowed to move from day to day, the idea being that it should not move by a large amount. This concept of slow devaluation or overvaluation is known as crawling peg system.

Ovilefuoma (1988) and Ogundipe (1987) enumerated the merits of this sytem over the floating exchange rate system as below:

i. Inability to effectively eliminate a country current account deficit or reduce a current account surplus, if the elasticities of demand for imports and exports are of an inappropriate value.

ii. Existence of uncertainty, if there are

considerable fluctuations in exchange rates under floating exchange rate system, traders will become reluctant to enter into commitments since transaction is no longer profitable to one of the parties and consequently, world trade may be inhibited.

iii. A country that maintains a fixed exchange rate, will experience inflationary impact, only when the *domestic currency is devalued. But if* exchange rate fluctuations are fairly large under floating exchange rate system, the economies with depreciating currencies will experience rising imports prices especially if imports form large proportion of Gross Domestic Product (GDP).

2.2.2 The Floating Exchange Rate System

This system allows the forces of demand and supply in forex market to determine a consistent set of exchange rates. Thus the ruling exchange rates must be freed from arbitrary control by the government if the demand for a currency relative to another currency increases, the rate of exchange will rise and if the demand for it decreases the rate of exchange will decline.

The variant of this system or managed floating exchange rate, is adopted by both developed and developing countries in which government intervene to redress any perceived wrong signals arising from market imperfections. The advantages of the floating Exchange rate include:

1. It is very simple system. The forces of demand and supply determine the appropriate rate for each currency. And no need for countries to decide what constitute the appropriate exchange rate.

ii. It improves the balance of payment situation, if adopted when a country is consistently suffering from balance of payment deficit if its currency is allowed to float independently, a gradual depreciation of the domestic currency results, therefore, providing necessary stimuli to export and discouragment to imports.

iii. Under the fixed parity or the crawling peg system, deficit countries has to direct fiscal and monetary policies at the external situation since expenditure reducing is the way in which the balance of payment could be improved without devaluation. As a result, internal policies are often

dictated by external situations.

2.3 The Exchange Rate Policy in Nigeria

The main objectives of exchange rate policy in Nigeria are to preserve the value of the external reserves and maintain a stable exchange rate for the naira. This has implications for external and internal macro-economic adjustment and equilibrium. These policy objectives have been realised by the use of measures such as:

i. Maintaining a one-to-one parity with the British pound sterling till 1967 when the sterling was devalued and a fixed parity with the U.S. dollar from 1967 to March 1974 was pursued.

ii. Fixing the naira exchange rate independently with dollar and sterling depending on their relative strengths, for the period between April 1974 to 1978 and

iii. The use of judgement, based on performance of several macro-economic variables, such as trade-weighted currency ratios, balance of payments, level of reserves and relative rates of inflation for the period begining from February 1978 to December, 1983. From 1984 to the end of 1986, the naira exchange rate followed a

crawling peg regime tied to a trade-weighted basket of currencies as a way of achieving an equilibrium real effective exchange rate. This resulted in 20 per cent depreciation of the naira by the end of the period.

Furthermore, the major short coming of the measures adopted so far, was its inability to achieve internal balance in the short-term and gurantee external equilibrium in the long term. Overvaluation of currency under the system was a major obstacle that made the achievement of internal balance difficult. The problem with the administration of the exchange control system can be summarised as increased dependence on imports, depletion of external reserves, encouragement of parallel market activities, reduction of competitiveness in export activities reduced capital inflow and the inability to pay on current basis. This led to the accumulation of payment arrears which compounded the external debt. This system was discarded on September 26, 1986.

At the inception of SAP, the forex market was partially deregulated and the mechanism of exchange rate determination and allocation of forex under this deregulated system is based on market forces of demand and supply. Though, these forces are expected to interact and produce a clearing price as the base for the allocation of forex, the monetary authories still intevene in the market, where developments so warrant. Such intevention stressed by Ukpang (1993) depends on the state of balance of payments, the rate of inflation, domestic liquidity and employment. Within the basic framework of market determination of naira exchange rate, various methods have been applied and some adjustments carried out to fine-tune the system.

The SFEM was initiated in September, 1986 for the purpose of buying and selling Forex at realistic market rates. The first-tier rates was reserved for diplomatic and some government transactions while second-tier rate was for other transactions. The second-tier rate was determined by auction of SFEM by averaging of successful bids of authorised dealers. Likewise marginal rate was also adopted as the market exchange rate. In 1987, Dutch Auction System (DAS) was introduced, used the marginal rate as

the market exchange rate. The first and second-tier exchange rate were later marged. In response to the continued depreciation of the naira, DAS was re-introduced in December, 1990 and through most of 1991. To further stabilise and find an appropriate exchange rate for the naira, a floating exchange rate regime was adopted on March 5, 1992. The Forex market was completely deregulated and Forex leakages from authorised dealers to parallel market were reatly curtailed. From then the CBN joined the forex market both as a buyer and seller, enabling it to influence the exchange rate of the naira directly.

2.4 Problems and Gains of Deregulation of Forex Market Since 1986

The policy measures and strategies adopted by CBN so far since the SAP, increasingly reflected the deregulatory stance of the package. Under the deregulatory stance of the SAP, the bank's determination of the naira exchange rate had been subjected to market forces. Though, there had been experimentation with several techniques of conducting the Forex Market between 1987 and 1992 to facilitate the achievement of policy objectives. Also on March 5, 1992, the policy of complete deregulation of the forex market was adopted in response to the emergence of a large

parallel market premium and abuses by many operators. The new problems created and gains made in recent economic reforms perceived by different writers in their articles or books are written below.

Oke (1990), mentioned that the most visible gain of deregulation of forex market was its ability to resolve the problem of over-valuation of domestic currency, beside this, it had enhanced administrative and allocative efficiency of the economy, it had encouraged the flow of forex from non-official sources, rationalised the demand for imports and stemmed capital flight. It also helped economic agents to plan ahead their production and investment activities. Most importantly it had fostered the culture of repair and maintainance of durable assets and local fabrication of simple machinery and industrial spare parts. He also observed that depreciation of Naira had been a boost to non-oil exports.

Thompson (1992), found out that industries and other users of forex now had more access to it compared with pre-SAP of forex rationing through import licencing and pervasive administrative controls. Before forex market was deregulated in 1986, though, Naira was over-valued but forex

was difficult to come by. The lack of easy access to forex made it hard for manufacturers to keep themselves supplied with imported inputs. Consequently by the time the market was deregulated, many industries had folded up. With the adoption of deregulation of forex market by the policy markers, naira continued to depreciate. As a result it started costing more and more naira to procure the needed forex by industries. With passage time, industries could no longer find naira cover to foot the high forex bills. This led to closure of many industries which brought them back to square one. Those who remained in operation, embarked on drastic reductions in their staff strength, consequently increasing on unemployment problem in the country.

According to Jason (1992), backward integration was making steady progress and that manufacturers were now beginning to appreciate it. He stressed that the adoption of backward integration by many industralists was as a result of inability to find naira cover for their forex requirements which forced them to source their raw materials locally and to reorient the factories to use them. The major consualities of deregulation of forex were breweries, soap and detergents manufacturers,

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beverages and confectionary manufacturers but now bigtime farmers, producing their requirements of wheat and maize. The leading soap makers turned from importing palm oil from malaysia to Nigeria's once flourishing palm oil plantation. The confectioners have coverted to sorghum malting. Cadbury Nigeria draws heavily from locally produced raw materials. Textile manufacturers such as Afprint and Texlon had all invested in cotten farms. Furthermore, he emphasised that beside the achievement of backward integration, by the industrial sector, some impediments appear to stifle the efforts of government as this sector continued to suffer from frequent interruption of public utilities such as electricity, water, telecommunication, transport and waste disposal. Owing to the break-down of these social infrastructures, the prices of locally produced goods remained uncompetitative.

Olisadebe (1991) emphasised that the major problem of deregulation of forex market to the industrial sector was persistent low level of industrial output. He argued that capacity utilization in the industrial sector remained low falling from average of 47 per cent in period 1981 - 1985 to 40 per cent in 1986 - 1990. The years 1991 - 1993 also withnessed low

level of industrial output confirmed by Manufacturers Association of Nigeria (M.A.N) and capacity utilization as the end of 1993 was 28 per cent. This decline was attributed to low rate of which basic raw materials were imported as a result of high costs of imported inputs induced by low value of Naira.

Aningwu (1992), found out in his research that manufacturers believed in the efficacy of deregulation of Forex Market and inability to achieve its objectives was due to poor implementation strategy. He stressed that industrial sector was adversely affected and also, the sector withnessed a negative impact on its profitability.

Ogwuma (1993) and Ukpong (1993) mentioned in their articles that stability of naira exchange rate was still elusive because of constraints such as rapid growth in liquidity, persistence of large government deficite and its mandatory financing by CBN., inadequate inflow of forex and prevaling high interest rates. Also inability to achieve exchange rate stability was partly explained by frivolous and speculative demand for forex and authorised forex transactions. He also stressed that the low level of domestic output that failed to catch up

with domestic absorption (expenditure), the increase of which was mainly accounted for by government, also contributed to the excessive pressure on forex resources. Thus, the disbursement of forex, although at a lower level than in pre-SAP years was still higher than foreign exchange receipts.

Lolo (1992), stressed that one of the positive impacts of deregulation of forex market was cash and carry system had drastically reduced trade arrears and restored the country's worthiness to a great extent. Another gain stressed by him is the encouragement and subsequent development of non-oil exports. Apart from traditional export crops such as cocoa, rubber palm produce, number of item such as fruits, textiles and beer now enjoy a boost in export sector.

According to Zyayad (1994), the policy of deregulation pursued by policy makers during the past years had been a blessing and a curse. On the positive side, the country withnessed a phenomenal growth in financial sector. The number of banks increased from forty three (43) in 1986 to about one hundred and twenty (120) by 1992 enormous job opportunities were created, creation of competitative environment and enhenced the quality and sophistication of

service delivery.

On the negative side, deregulation increased the incidence of bank fraud both in their size and sophistication and reduce confidence in the system. Though, over this same period of economic difficulties both sectors continued to declare huge profits but M.A.N attributed these profits in industrial sector to efficient management and reductions in overheads.

2.5 The Financial and Manufacturing Sectors of Nigerian Economy

2.5.1 The Financial Sector of Nigerian Economy

It has undergone remarkable changes in recent times following the policy of deregulation, the system has become market ariented and the banking sector particularly withnessed a remarkable growth between 1987 and 1991. This sector consists of banks and non-bank institutions and can be grouped into seven, namely:

i. The Central Bank of Nigeria (CBN)

ii. Federal Ministry of Finance (FMF)

iii. The securities and Exchange commission (SEC)

iv. Commercial and Merchant banks

v. Development Financial Institutions (DFLS)

vi. Specialised Institutions

vii. Other financial institutions and funds.

The Central Bank of Nigeria (CBN)

This is the apex regulatory authorities of financial sector, the CBN continues to carry out its function of ensuring and fostering monetary stability.

The Federal Ministry of Finance (FMF)

The FMF advices the Federal government on its fiscal operations. The ministry handles budgeting and planning and interact with CBN on monetary matters. The supervision and licensing of banks was shared responsibility of CBN between FMF and CBN, until the CBN became autonomous. FMF is also responsible for licensing bureaux-de-change and regulating insurance companies.

The Securities and Exchange Commission (SEC)

This is the apex regulatory organ of the capital market. Its major objective is the promotion of an orderly and active capital market. Its functions to ensure adequate protection of investing public. In the course of deregulation of the capital market, the function of price determination has been transferred to issuing houses. However, the SEC continues to maintain

surveillance over the market to enhance efficiency.

Commercial and Merchant Banks

These are money creating institutions in Nigeria and play a major role in the development process. The commercial banking sector has continued to withness rapid growth, in terms of number of institutions and innovation since government commenced a policy of deregulation in 1986.

The Merchant banks are the wholesale bankers that cater for the needs of corporate and institutional customers. Their role in the economy is to provide medium to long-term finance by engaging in activities such as equipment leasing, loan syndication and debt factoring, including project financing. Merchant banks also do not have widespread branch network owing to the nature of their operations.

Development Finance Institutions (DFIs)

They are institutions established specifically to contribute to the development of specific sectors of the economy. They consists of the Nigerian Industrial and Development Bank (NIDB), The Nigerian Agricultural and Co-operative Bank

(NACB), and the Federal Mortgage Bank of Nigeria (FMBN). These institutions are not directly under the supervision of the CBN, thus, not affected by CBN's monetary and credit guidelines.

Specialised Institutions

These institutions are established to mainly cater for the banking needs of some segments of the society such as petty traders, persant farmers deprieved communities. These banks include People's Bank of Nigeria (PBN), Community BAnks and Urban Development Bank (UDB).

Other Financial Institutions and Funds

These institutions and funds within the financial system which play important roles as intermediaries. These include, the Nigerian Deposit Insurance Corporation (NIDC), Insurance Companies, Finance Companies, Discount Houses, Bureaux-de-change, the National Economic Reconstruction fund (NERFUND) and the National Provident Fund (NPF).

The principal operators of Financial Sector in Forex Market are the commercial and the Merchant Banks. These banks buy their forex needs from the major supplier, the CBN and also buy from

individuals and organisations that are ready to

sell. The banks in turn sell to manufacturing companies, importers and other users.

Also the Bureaux-de-change is also authorised by CBN to buy and sell foreign currencies. They are established basically to meet forex requirements of clients that need foreign currencies. They are established to meet forex requirements of clients that need foreign currencies in small amount; such as the pilgrims and Basic Traveller's Allowance (BTA). The source of foreign currencies is from the public and also sell to the public.

The parallel market operators are not authorised by the CBN to deal in forex transactions. Sources of forex to this body are from exporters of local products who preferred to get higher naira value for their foreign currencies. Unpatriotic acts of some banks which diverted forex to illegal forex market and from individuals that are ready to sell.

The Manufacturing Sector of Nigerian Economy

The manufacturing sector consists of Beer and Stout Industry, soft drinks industry, cotton Textile industry, Paints industry, Cement Industry, Soap and Detergents, vehicle Assembly

Industry, Roof Sheets, Sugar Confectioners,

Refined petroleum industry and so on. The scale of production of goods ranges from small to large scale. Before the advent of SAP, Nigeria's industrial policy was geared towards self reliance. There was transfer of technology and import substitution policy whose effect was the establishment of industries which duplicated off-shore factories and depended on 100 per cent imported raw materials. The experts who were supposed to impart technolgical know-how to Nigerians were found to be mere artisans. The industries depended on imported completely knock-down (CKD) kits and could not run without subsidies because of deliberate built in absolescence practised, with frequent switch of models.

Under SAP, Jason (1992) reported that the policy was geared towards the local sourcing of raw materials and orientation of the factories to use them. As a result of this policy, manufacturing activities slowed down and there was need to refool factories to plant and harvest; especially if they were to be available in commercially viable quantities. To back the drive to self-reliance and self sufficiency for Nigerian industries, the Raw Materials Research and Development Council (RMRDC) was established

to help industralists indentify broad range of available but untapped raw materials for production options. This area offers opportunities to any Foreign Investors who wants to make money. Still under SAP, the government's policy goal is to disengage completely from direct manufacturing and to increase local sourcing of raw materials. Though the government insists on an improvement concerning the state of manufacturing industries, especially policies that would enhance the level of capacity utilization but this has been elusive since the introduction of SAP in 1986.

Another policy that had slow down the manufacturing sector was the liberalisation of lending rates which translated the high costs of capital into a general dislocation of the economy. The most far-reaching policy introduced was the deregulation of forex market with its persistent depreciation of naira continues to make it difficult for manufacturers to find naira cover to foot their foreign exchange requirements.

CHAPTER 3

THE FOREIGN EXCHANGE MARKET BEFORE THE COMPLETE DEREGULATION (1986 - 1991)

The realization by the policy makers that the Naira was over-valued led to the search for realistic exchange rate. Thus, the Structural Adjustment Programme (SAP) was introduced in 1986 and the core component which was Second-tier Foreign Exchange Market (SFEM) was targeted at correcting the over valuation of Naira. While the basic frame work for operating the exchange rate policy ramained the same, the modalities had been continously fine-tuned through various changes in operating rules and complementary measures in monetary and fiscal policies. These were also aimed to achieve the objectives of exchange rate policy under SAP. The objectives include:

i. Correction of the over-valuation of the Naira exchange rate through the achievement of a realistic rate.

ii. Reduction of dependence on imports and oil exports.

iii. Diversification of the export base.

iv. Reduction of incidence of capital flight.

v. Encouraging local production of inputs.

vi. The achievement of balance of payments viability in medium term.

vii. Elimination of payments arrears.

viii. Reducing or eliminating the parallel market premium thereby improving resource allocation and enlarging the scope of ligitimate foreign exchange transaction.

The policy measures taken since commencement of SAP in 1986 and before the complete deregulation of Foreign Exchange Market in 1992 are discussed below.

3.1 The Dual Exchange Rate System

At the commencement of the second-tier Foreign Exchange Market (SFEM) on the 26th of September, 1986, a dual exchange rate system for the allocation of Foreign Exchange (Forex) was adopted.

The First-tier rate applied to all pre-sfem or transtional transaction, debt service payments, contributions to international organisations and embassy expenses while second-tier Forex rate was applicable to all transactions except these settled at the First-tier rate.

The Second-tier rate was determined by auction at SFEM. The authorised dealers were required to bid for forex subject to their allocation ceilings and at prices that appeared to them approximate the market perception of demand for and supply of forex. Banks were grouped into five namely: Big and Small in order to ensure equity.

The big banks could buy a maximum of 10 percent while small ones bought a maximum of 7 per cent. Under this arrangement, many banks failed to win at the auctions. In order to induce more banks to be successful winners, they were further categorised into, Big, Medium and Small with each category entitled to 5, 2 and 1.5 percent respectively. In the first two auctions in SFEM the average of successful bids of authorised dealers was used to determine the exchange rate. In the auction the average pricing method was abandoned and replaced with marginal rate pricing, owing to the observed continous depreciation of Naira. Thus, Marginal rate was adopted to reduce this depreciation to the bearest minimum under this method, the last successful bid determined the clearing price which was also the ruling rate. Unfortunately, this method did not succeed in entrenching professional displine in the system as the biddings appeared unrelated to market situations.

To introduce more professionalism into the bidding system, the Dutch Auction System (DAS) was put in place in April, 1987. Under Dutch Auction System of foreign exchange market, individual bank bidded for forex at an exchange rate it felt suitable for its customers without making the bid rate known to other bank participating at the auction. Thereafter the Central Bank of Nigeria (CBN) collected all the rates of participating banks and individual bank rates were used to allocate forex up to the marginal rate which cleared the market. The aim was

to reduce the propensity for high bids but this system, however, created the problem of multiplicity of rates along with further depreciation of Naira. Also, the bidding period was changed from once a week to once in a forthnight.

3.2 The Unified Exchange Rate System

In July, 1987 both the First and Second-tier Markets were merged into Foreign Exchange Market (FEM) along with abolition of dual exchange rate system and all transactions were at a result, priced at the second-tier rates. This arrangement was to eliminate the subsidy on First-tier transactions, rationalise the allocation of forex and eliminate multiple currency pratices and still pre-sfem transactions continued to be excluded from this system. This arragement increased demand pressures and contributed to the persistent depreciation of the Naira exchange rate, according to Ukpang, G.E (1993).

In 1988, the autonomous market for privately sourced forex emerged with its independent rate, the forex sourced by banks privately was sold by them at rates determined also by them but subject to a maximum spread of one percent. The objective of the autonomous forex market was to

encourage non-oil forex inflow to banks and thereby reduce the pressure on the official market. This arrangement was abolished in January, 1989 as a result of its inability to foster the stability of the Naira exchange rate and also because of distortions it induced in the system.

3.3 **The Inter-bank Foreign Exchange Market (IFEM)**

The abolition of autonomous foreign exchange market in January, 1989 resulted in its subsequent marger with the Foreign Exchange Market (FEM) to form the Inter-bank foreign Exchange Market (IFEM). The objective of this policy measure was to unify the rates in official and autonomous segments of the market so as to reduce the distortions inherent in the old system. Auctions were held on a daily basis and the exchange rate under this arrangement was determined by using or a combination of the following methods:-

i. Average rate pricing

ii. Marginal rate pricing

iii. Highest and lowest bid

iv. Weighted average pricing

v. Average of successful bids and

vi. Consideration of developments in the exchange rates of major international currencies.

All dealing banks were grouped into four and ranked from biggest to smallest, the grouping was based on the weighted average of a number of factors such as Net profit, loans and advances the banks levels of net assets and deposit liabilities.

Olisadebe (1991) found that the classification was important for purposes of determining the amount of forex that should be allocated to each bank. Furthermore, the proportion of total allocations that went to each group and bank was not immutable but changed to reflect the number of banks that came into market for the first time as well as amount of forex the CBN was prepared to put into the market. In general, in determining the amount to be allocated to the banks, the CBN considered the level and stability of forex inflow and also the stock of contigent liabilities of the monetary authories.

Another important feature under the arrangement was that dealers bought forex on their own account instead on the behalf of their customers as it was the previous case. The practice was adopted based on the need to allow the dealing banks cater for the interest of their customers in all their branches within the country. Each bank's account with CBN was debited with Naira equivalent of the allocations once the

allocations had been taken up. Thus the CBN sold usually 0.5 per cent above the market rate. This arrangement was characterised by dealing banks not allowed to use funds so acquired for inter-bank transactions, thus, dealers that came to the market were allotted their share of total allocation.

3.4 Bureaux De-Change

In 1989, another policy measure was taken, thus made way for introduction of Bureaux De-change. These institutions are licensed or authorised by CBN to buy and sell on a relatively small scale. Those are established basically to meet foreign exchange requirements of clients that need foreign currencies in small amounts such as pilgrims and Basic Travellers' Allowance (BTA).

Their operations are aimed at enhancing the free access of forex to small users in a convenient and informal manner, thereby filling the gaps under existing arrangements. The institutions could also provide competition to the parallel or unofficial market and possibly marginalize it. The source of foreign currencies for bureauz de-change is from public and they also sell to the public.

3.5 Re-Introduction of Dutch Auction System (DAS)

On December 14, 1990 the Dutch Auction System

(DAS) was re-introduced to check deficiencies in the market such as foreign exchange hoarding, submission of multiple bids, thus, inflating the demand forex, selling of a greater percentage of their forex to airlines and other users in the services sector, instead of channelling them to the productive sectors in accordance with laid down rule.

Ndiudor (1993) found that the new system was seen as a victory to bankers at the time they had solicited for its return so as to guarantee efficiency in the allocation of forex to dealing banks. Also, that it would enable the dealers to bid at a rate which they deemed most favourable to their customers, based on the customers requests.

Under this arrangement dealing banks paid for their foreign exchange allocation at their bid rates and each successful bidder's account with the CBN was debited automatically with the Naira equivalent of the bank's dollar allocation. Therefore each bidder made substantial effort adequately fund its account before coming to the market. The dealing bank which failed to adhere to these guidelines were automatically barred from participating in the market for a certain period. Persistent underfunding of accounts with CBN led to permanent exclusion from the

market.

The dealing banks were categorised into six classes based on four factor which included, Shareholders funds, deposit base, loans and advances and profit before tax. This marginal rate continued to be used to determine the official rate. This rate was marked up by one per cent to determine effective rate. The CBN buying and Selling rates were accordingly determined by adding and subtracting 0.5 per cent. The banks determine their rates through their individual bid rates subject to a margin of 0.5 per cent on either side of their bid rates.

3.6 Modified Dutch Auction System (MDAS)

On August 14, 1991, MDAS was introduced owing to persistent depreciation of Naira exchange rate, despite the re-introduction of the DAS in December, 1990. Although the issuance of stabilization Securities in March and April of 1991, to mop-up the perceived excess liquidity in the system, it was observed that the Naira exchange rate exibited flashes of strength but this was short-lived as it was clear by the mid-August, that unless urgent measures were taken the sharp depreciation of the Naira exchange rate might vitiate the other objectives of the policy.

Furthermore, to intensify the excess liquidity mopping-up operation in the economy and also to deal with the problem of multiple applications from bidders and reduce speculative fever, the MDAS was introduced by the CBN. Ndiudor (1993) found that the banks did not like this new system and accused the CBN of wanting to hide under the inadequacies of the system and secretly devalued the Naira and after pass the blame to the dealers. Also that this system would worsen the exchange value of Naira because of the adverse effect of competitive bidding engendered in it.

Under this new system, dealing banks were to bid on behalf of their customers but were not allowed to bid on their own behalf. According to Awomolo (1992) accounts of the customers with the bank were automatically debited with the Naira equivalent of their foreign exchange requests at the time the request was made. Likewise, the banks accounts with CBN were automatically debited at the bid rates plus one per cent mark-up. The weighted average method was used in exchange rate determination, either, the bid rate of each dealer was weighted by its demand for forex and aggregated to arrive at a weighted average for all the banks. Thus weighted average was marked-up by a spread of

one per cent to arrive at the effective rate from which the buying and selling rates were determined. Success at the auction by dealing bank under this arrangement, depends on the extent of deviation of its bid rate from the weighted average.

Under normal condition, the smaller the deviation the higher the chances of a bank succeeding. Therefore the highest and lowest bidders lost and effective rates were determined by moderate bidders. This variant of the system was introduced to check the alleged unprofessional bidding methods of dealers.

3.7 Complementary Measure

The complementary measure were also taken to restrict the demand for available forex resources and to increase the supply of forex to meet the Nation demand at a desired level.

In Jan., 1986 in order to restrict demand of forex in the area of monetary policy, the existing ceiling of 10 per cent imposed on the rate of credit expansion by banks was reduce to 8 per cent. In the same year, the CBN in response to complaints made by many banks that the 10 per cent ceiling was restrictive. Adherence to the new 8 per cent they further claimed would starve the key sectors of the

economy of the needed credit. This was further reduced in August 1987 to 7.4 per cent.

Ojo (1992) found that under the reflationary package of 1988, the credit expansion of commercial banks was raised to 12.5 per cent. As a result of excessive inflationary pressures generated by the rapid monetary expansion arising from the package.

Furthermore, in 1989, the banks' cash requirements and the Minimum Re-discount Rate (MRR) engaged upward reviews. In addition, banks withnessed increase in liquidity ratio and further raise in cash requirements. Efforts were made by the policy makers to reduce excess liquidity of the banking system in form of abolition of foreign gurantees or currency deposits as collaterals for naira loans. The abolition of foreign gurantees of currency deposits as collateral for naira loans meant that banks were no longer to grant domestic loans denominated in naira on the securities of foreign gurantees or deposit held abroad and in domiciliary accounts with the banks.

In the area of fiscal policy, the treasury circular of May 26, 1989, directed that all Federal and state government deposits and those of their agencies be transfered from commercial

banks to the CBN Deposits transfered totalled N8.5 billion at the end of July, 1989 according to Olisadebe (1991). Oduyemi (1993) found that indirect measures adopted by the CBN since October, 1990, to mop-up banks' excess liquidity are issuance of stabilization securities to them.

On the supply side, measures adopted were to maintain adequate level of forex reserves, thus, the government continued to provide incentives designed to increase non-oil export receipts and diversify export base. The incentives according to Olisabade (1991) included right of exporters to retain 100 per cent of their proceeds in their domicillary accounts and used them for legitimate transactions. Debt management policies through reschedulling, restructuring and debt conversion have also been supportive of exchange rate policy. The Rediscounting and Refinancing Facility (RRF) was established by CBN in 1987.

CHAPTER 4

THE EFFECTS OF COMPLETE DEREGULATION OF FOREX MARKET ON FINANCIAL SECTOR OF NIGERIAN ECONOMY

On March 5, 1992, financial sector of Nigerian economy withnessed a complete dregulation of Foreign Exchange Market. This action set panics into the money market. The CBN adopted this new system as a result of the persistent instability in the forex market, reflected in the wide divergence of the rates between the official and parallel markets, in spite of previous policy measures (SFEM, FEM, IFEM).

Secondly, moral suasion by the government that banks should be professional and patriotic in their bidding at SFEM, IFEM, and FEM fell on deaf ears.

Thirdly, the malpractices perpetuated by the authorised dealers in Forex, such as channelling officially subsidied forex to parallel market.

The new system of forex trading was to achieve the following objectives of the government:

1. To check the malpractices perpetuated by authorised dealers in forex especially the banks which were channelling officially subsidied forex to parallel market.

ii. To close the gap between the official and parallel rates and allow the official rate of naira find its value

against the parallel market value.

iii. To enhance the operational and allocative efficiency of forex market.

iv. To generate huge amount of money for government coffers by removal of subsidy on Forex.

After the abolition of the official Foreign Exchange Market (FEM), the CBN came out with the guidelines for trading in foreign currencies in the inter-bank.

The effects of this new forex policy are discussed below:

4.1 **Effects on The Stability of the Official Exchange Rate**

The table 1, below shows the relative stability of exchange naira rate in the periods under study:

Table 1

The Official Naira Rates (1986-1993)

Monthly Average	Effective CBN Rate (N)/$	Drepreciation %
1986	3.76	-
1987	3.97	5.3
1988	4.50	11.8
1989	7.41	39.3
1990	8.04	7.8
1991	8.04	7.8
1992	17.32	42.9
1993	22.16	21.6

Sources: Compiled from CBN Annual Report and Statement of Accounts

Generally, on table 1, the Naira/Dollar monthly average rate depreciation from N3.76 to $ in 1986 to an average of N22.16 to $ in 1993. This show continuous depreciation of naira exchange rate since inception of SAP.

In the period 1986 - 1991, under the partial deregulations of Forex market, the percentage depreciation of Naira increased from 5.3 per cent in 1987 to 39.3 per cent in 1989 and noticeable decreased to 7.8 per cent in 1990 and finally increased to 19.0 per cent in 1991. The 7.8 per cent depreciation recorded was as a result of introduction of complementary measures which helped to reduce the pressure on the exchange rate. But unfortunately this did not last as the naira exchange rate continued to depreciate in the following years.

In period 1992 - 1993, under the full deregulation of Forex Market, the Naira exchange rate persistently and substantially depreciated in the official market. The Naira/Dollar monthly average rate depreciated from N17.38 in 1992 to N22.16 in 1993. While 42.9 per cent depreciation was recorded in 1992 which decreased to 21.6 per cent in 1993.

This shows that the full deregulation of forex market had done more harm to naira exchange rate. When compared to partial deregulation policies. This, naira exchange rate had become more unstable in the period 1992 - 1993 relative to the period 1986 - 1991.

4.2 Effect on Parallel Market Premium

The figure 1 and table 2, below shows how the parallel market premium was affected by deregulation of forex market in the two periods under study.

Table 2

Parallel Market Premium

Monthly Average	Official Rate (N)/$	Parallel Rate (N)/$	Parallel Market Premium (%)
1986	3.76	4.17	10.9
1987	3.97	5.58	39.8
1988	4.51	6.05	34.2
1989	7.41	16.54	42.2
1990	8.04	9.61	19.5

1991	9.93	13.54	37.4
1992	17.38	27.25	50.7
1993	22.16	38.50	73.7

SOURCES: Various Newspapers.
Compiled from CBN Annual Report and Statement of Accounts.

Under the partial deregulations of Forex Market in period 1986 - 1991, 30.7 per cent was the average parallel market premium and this increased to an average of 65.2 per cent in period 1992 - 1993 when the Forex market was completely deregulated. This shows that the misalignment of the exchange rate had increased comparatively.

In period 1986 - 1991, year 1990 recorded significant decrease in parallel market premium of 19.5 per cent from 42.2 per cent of the previous year 1989 as a result of tough monetary and fiscal measures embarked upon by the CBN. The premium widened again to 37.4 per cent in 1991.

In period 1992-1993, the parallel market premium increased from 56.7 per cent in 1992 to 73.7 per cent in 1993. The increasing marked parallel market premium in this period shows continued misalignment of the naira exchange rate due to excessive demand of forex and speculative acitivities. Thus, in effect, the completely

deregulation forex market contributed significantly to the widening of gap between the official and parallel markets rates.

4.3 Effect on Demand Gap

The figure 2 and table 3, below shows the effect of the new policy of full deregulation of forex market on the demand gap compared with the policy measures of partial deregulations.

Table 3

The Demand and Supply of Forex in the Official Market

Monthly Average	Total Demand By Bank (US$M)	Total Supply By CBN (US$M)	Demand Gap (US$M)
1986	916.00	871.1	44.9
1987	2,785.0	2,330.4	454.6
1988	3,259.9	2,711.1	548.8
1989	17,337.3	2,163.2	15,174.0
1990	20,196.6	2,630.9	17,564.7
1991	9,452.3	3,086.8	6,366.3
1992	6,435.6	4,045.7	2,389.9
1993	40,641.9	2,892.7	37,749.2

Source: Annual Reports and Statement of Accounts of CBN

Generally the actual demand of forex by banks increased from $916m in 1986 to $20,196m in 1990 and decreased to $9,452.6m in 1991. This decreased in period 1986 - 1991, was as a result of continued effort of the CBN to drain excess banks' reserves through the issuance of stabilization securities. The action was taken by the CBN to halt the rapid pace of growth of

banks' reserves. This made it difficult for banks to get enough naira cover for their forex needs. Consequently, demand for 1991 was depressed.

In period 1992 - 1993, the actual demand by bank in 1992 decreased to $6,435.6m as a result of the further depreciation of naira by full deregulation of forex market amidst indications that the liquidity in banks was yet to ease. In 1993, the amount of forex demanded by banks increased to $40,641.9m. It was found out that banks inflated their demands in order to have more access to the official forex.

On the supply side, since the inception of SAP in 1986, the CBN is yet to met the total annual demands of Forex needs of the financial sector. The quantity demanded by banks always exceed the total supply by the CBN. Thus, every year there is always a demand gap.

The demand gap widened from $44.94m in 1986 to $17,565.7m in 1990 which later contracted to $6,366.3m in 1991. This decrease in demand gap in 1991 was due to issuance of stabilization securities to banks. The year 1992, withnessed a reduction of demand gap to $2,389.9 which later increased to $37,749.2 as a result of inflated demands by banks. This decrease

evidenced in this period was due to effect of the complete deregulation of Forex market. As the operators in Forex market held unto their Forex in anticipation of increase in earning and fear of uncertainties. And also, business of channelling official forex by unpatriotic banks to the black market was no longer thriving since the subsidy was removed.

4.4 Effect on Interest Rates

4.4.1 The Lending Rates

The figure 3 and table 4, below shows the First City Merchant Bank (FCMB), lending rates and marginal Re-discount Rate (MRR) from 1986 to 1993.

Table 4

FCMB Lending Rates

Monthly Average/ Year	Prime lending Rate %	Maximum Lending Rate %	MRR %
1986	9.50	13.00	11.00
1987	20.50	22.00	15.00
1988	16.50	17.60	12.75
1989	29.80	29.80	13.25
1990	28.50	29.00	18.50
1991	20.90	21.00	15.50
1992	44.40	48.10	17.50
1993	59.10	61.50	25.25

Source: Personal Survey

Generally, from 1987 to 1993, the financial sector withnessed the deregulation of interest rates, this gave individual banks a free hand in determining its deposit and lending rates according to market conditions through the negotiations with their customers except for year 1991 which the maximum lending rate was fixed at 21 per cent by the CBN as a result of increase in domestic liquidity while MRR was 15.50 per cent.

In period 1986 - 1991, the Prime lending Rate (PLR) and Maximum lending Rate (MLR) increased from 9.50 per cent to 29.80 per cent and 13.00 per cent to 29.80 per cent respectively. But in 1988, the PLR and MLR were 16.50 per cent and 16.60 per cent respectively.

These rates were lower than the rates of the previous year, 1987 and following the year 1989. The decrease in these lending rates in 1988 followed in response to reduction of Marginal Rediscount Rate (MRR) from 15 per cent in 1987 to 12.75 per cent in 1988. Similarly MRR was adjusted upward from 12.75 per cent to 13.25 per cent in 1989, thus, the PLR and MLR rates also increased to 29.90 per cent in this year. The decrease recorded in 1990 for these lending rates compared to the previous year 1989 was a result of withdrawal of government deposits from

banks accounts by CBN which reduced liquidity and moderated interest rates in general as the banks liquidity position improved increase in MRR from 13.25 per cent in 1989 to 18.50 per cent in 1990 did not show any significant effect on the lending rates as observed in the previous years.

In period 1992-1993, PLR and MLR increased from 44.40 per cent to 59.10 per cent and 48.10 per cent to 61.50 per cent respectively. Also the MRR increased from 17.50 per cent in 1992 to 25.25 per cent in 1993. The situation had worsen under this period compared to period under partial deregulation of forex market. This was as a result of increase in demand for funds for purchase of high naira cost of forex. This was caused by the oligopolistic structure of banks, in which few banks constituted a major suppliers of fund in the inter-bank market leading to charging of higher risk premium by participants in the financial market and also rapid spread of distressed financial institutions as these tended to depend heavily on inter-bank funds which attract high interest charges.

4.4.2 <u>The Savings and Time Deposit Rates</u>

The table 5, below shows Marginal Rediscount Rate, savings rates and Time Deposit rates of

Eko International Bank (EIB) from 1986 to 1993.

Table 5

EIB Deposit Rates

Monthly Average	MRR %	Savings Rate %	7 Days %	1 Month %	TIME DEPOSITS 1-3 Month %	3-6 Month %	6-9 Month %	Over 12 Mths %
1986	11.00	9.50	8.50	9.75	10.00	10.50	11.00	11.20
1987	15.00	12.50	12.60	14.10	15.30	15.10	15.80	16.00
1988	12.75	12.40	12.10	13.00	14.10	14.50	14.50	14.50
1989	13.25	13.10	17.40	18.40	19.50	17.10	20.80	-
1990	18.50	17.50	18.30	18.90	19.80	20.80	21.70	21.90
1991	15.50	13.50	14.20	14.80	15.30	16.20	16.80	17.20
1992	17.50	17.50	17.40	17.80	18.90	20.10	20.30	20.40
1993	25.25	26.00	22.60	25.00	27.00	27.80	28.80	29.00

Source: Personal Survey

In period 1986 - 1991, interest rates were generally fixed by the government till 1986 but active interest rate policy started in 1987 when banks were allowed to negotiate the interest rates on Savings and time deposits. The CBN set the minimum interest rate levels for Savings all 11 per cent and time deposits at 12 per cent while the EIB negotiated higher rate of 12.50 per cent with their customers. The interest rates on Time Deposits in 1987 also ranged from 12.60 - 16.00 per cent. Furthermore, the MRR increased from 11.00 per cent in 1986 to 15.00 per cent in 1987 which enhanced the increase in the Savings and time deposit rates.

In year 1988, the MRR was decreased to 12.75 per cent, from 15.00 per cent in 1987, thus, savings rate also decreased from 12.50 in 1987 to 12.40 in 1988. Also all other classes of time deposit responded in the same direction. Also, in 1989, the MRR was adjusted to 13.25 per cent, interest rates on Savings and Time Deposit also increased. The withdrawal of government funds from banks' accounts by CBN reduced its liquidity and further increased Savings and Time Deposit rates. Thus, the Savings' rate moved from 12.40 per cent in 1988 to 17.50 per cent in 1990 while the Time Deposits ranged from 12.10 - 14.50 per cent in 1988 to 15.30 - 21.70 percent in 1990.

In 1991, the Savings' rate decreased to 13.50 per cent from 17.50 per cent in 1990 due to interest ceilings. The maximum lending rate was capped at 21 per cent while Savings rate was allowed a minimum level of 13.5 per cent.

In period 1992 - 1993, the interest rate on Savings deposit increased from 17.50 per cent to 26.00 per cent in 1993. Likewise time Deposits' rate moved from a range of 17.40 - 20.40 per cent in 1992 to 22.60 - 29.00 per cent in 1993. The removal of interest rate ceilings coupled with liquidity management by CBN in response to

the exchange rate deregulation resulted in high interest rates. The high and unstable interest rate regime was attributed to activities of distressed institutions rising incidence of default in inter-bank obligations and the oligopolistic practices of some liquid banks as well as crowding out" effect of high fiscal deficits financed by the banking system.

4.5 Effect on Competition

In period 1986 - 1991, the Financial sector withnessed significant growth in number of banks and non-bank financial inter-mediaries until in 1991 when the government suspended the issuance of new banking licenses. As the government continued to allow the forces of demand and supply in forex market to determine an appropriate exchange rate for naira and ensuring its stability, the policy makers had from time to time, adjusted the mechanism for operating the market to make it more efficient. Thus various measures and options were adopted in the continued search for realistic exchange rate. The reforms under the period of partial deregulations of Forex market generated keen competition among the financial institutions for Savings and time deposits and bankable projects as evidenced by the spate of advertisement in both print and electronic media. The adoption of electronic devices and computerisation had

also improved the quality of banks services. Also, banks continued to show good income performance, reasonable good asset portifolio and adequate price earning ratio while relative small but insignificant number remained weak, unstable and severally destressed.

In period 1992 - 1993, the Forex Market caused a keener competitions among banks compared to the period 1986 - 1991, banks which couldn't compete became distressed.

The banking sector experienced re-emerged problems such as high unstable interest rates, distressed financial institutions exchange rate instability and the mandatory financing of fiscal deficit by CBN with attendant adverse implications for macro-economic stability and rising incidence of Fraud and default in inter-bank obligations.

For survival under these re-emerging problems many banks turned to short-term lenders, financing of Bankers' acceptances or commercial papers and local purchase orders. Many also continued to place their inter—bank funds strictly on call because of continued uncertainty surrounding monetary policy which in turn meant that lending to customers on medium and long term would remain uncertain.

The banks also stressed that the objective of CBN to close the gap between the parallel and official rates would be difficult to achieve, if the current documentary requirements and other restrictions were not reduced to enable banks to compete effectively against the parallel market operators.

Under this new policy, to obtain Forex from any source and sell to the customer on presentation of approved documents which included:

i. Tax Clearance Certificate

ii. Documents of what to be imported.

iii. Certificate of Incorporation and Trading and

iv. Visa and International Passport in the case of travellers.

Banks pointed out that buyers endured ducumentation and other strict requirement because they were compensated by cheap foreign currencies at official rate. This era had passed and there was no justification of strigent ducumentary requirements from customers. Banks were at present at disadvantage in forex market.

In the face of rising cost of funds in the money market, many banks aspired for access to National Housing Fund (NHF), a potential source

of soft credits. National Housing Fund decree stipulates that "A Mortgage institution duly licensed under mortgage institutions act shall qualify for loans from the fund". Adding that such funds shall be available to mortgage firms at 5 per cent interest for non-lending members of public at maximum of 9 per cent interest. The exploitation of this new housing scheme is seen as one of survival strategies embarked by banks and also a latest choice for equity invesments.

CHAPTER FIVE

THE EFFECTS OF COMPLETE DEREGULATION OF FOREX MARKET ON MANUFACTURING SECTOR OF THE NIGERIAN ECONOMY

The effects of new policy measure of full deregulation of forex on manufacturing sector are discussed below.

5.1 Accessibility to the Official Forex

The new policy measure of complete deregulation of Forex market by the CBN during the period 1992 - 1993 had the most far reaching effects on the manufacturing sector. As the manufacturers were still battling with problem of inability to find the required naira cover for their forex bills, by the previous policy measures of partial deregulations in the period 1986 - 1991. This new policy measure which came into effect on March 5, 1992 exaggerated this problem. This problem became aggravated as a result of further increase in naira cost of forex.

Reference to table 1, shows that the naira/dollar monthly average depreciated from N3.76 in 1986 to an average of N9.93 in 1991 while the monthly average further depreciated from N17.32 in 1992 to N22.16 in 1993. Depreciation of 42.9 per cent was recorded in 1992 which was higher than previous year 1991 of 19.0 per cent which later decreased to 21.6 per

cent in 1993. Thus, evidence from the table 1 shows that this new policy had increased the naira cost of Forex. Thus, manufacturers' accessibility to the official forex becomes increasingly difficult.

Furthermore, the high naira cost of forex coupled with too much ducumentation procedures of the banks had also forced this sector to basically source its forex needs from the parallel market especially when the subsidy was removed. Also over 90 per cent of new banks were established by the owners to service their trading activities through the acquisition of official forex and illegal trading in free funds to the detrimental of manufacturing sector.

5.2 Accessibility to Loanable Fund

The massive devaluation of the naira under the period of full deregulation of forex market as a result of the arrangement adopted for the sale and pruchase of forex gave birth to high speculative interests as against long-term investment which the nation desires. The high cost of fund as a result of high lending rates by banks and deterioration in the exchange rate of naira resulted into massive escalation of working capital which was a disincentive to the much proclaimed desire of government to encourage local investment in this sector. The

high rate of inflation in the economy coupled with devaluation of naira vis-a-vis scarcity of funds, had resulted in substantial increases in the demand for working capital to finance the current operation of industries. Furthermore, banking sector refused to give loans to the manufacturing sector because the high interest rates on their previously existing loans resulted into bad debts and any further loan advances to this sector was bound to escalate the bad debts. Thus this sector's accessibility to loanable fund is becoming more difficult when compared to period before the adoption of the new policy measure.

5.3 On Domestic Price Stability

The SCOA Motors' reaction to the recent deregulation was to mark-up prices of their Peugeot cars. This hike in prices was unavoidable under unpredictable market situation. The hike in prices was the only way to ensure continuity in market under the prevailing market conditions. SCOA Motors is the major distributor of Peugeot Automobile Nigeria (PAN), which is the manufacturer of Peugeot cars. SCOA has shareholding of 30 per cent in PAN while the Federal Government shareholding is 50 per cent and the remaining 20 per cent share holding is owned by the public. This company recently went into assembling of

Peugeot pick-up vans.

The table 6, below shows the prices of one of Peugeot cars called 504 GR AC from 1986 - 1993 at Kaduna Branch of SCOA Motors.

Table 6

Prices of Peugeot 504 GR AC

1986 - 19993

Year	Selling price (N)	Increase (%)
1986	-	-
1987	77,270	-
1988	81,597	5.6
1989	134,427	74.0
1990	145,800	88.7
1991	180,000	132.9
1992	257,200	232.9
1993	555,595	619.0

Source: Personal Survey

In the period 1986 - 1991, the price of Peugeot 504 AC Car moved from an average of N77,270 in 1986 to an average of N180,000 in 1991. This indicates a continous increase in the price of this product. The average price for this period was N123,818.80.

In period 1992 - 1993, the price of this vehicle moved from an average of N257,200 in 1992 to N555,595 in 1993. While the average price for

this period was N406,398.50. This shows that the hike in price in each year in this period was more.

Evidence gathered from Kaduna branch office of SCOA motors, shows that shortage of official supply of forex, high naira cost of forex to purchase imported raw materials, cumbersome import process and high cost of fund forced this company to increase the prices of this car. This hike in price was also explained as a need to shore — up capital to meet continous depreciation of value of naira. There is also more hike in future if the naira slump further against foreign currencies. More importantly, the hike in price was exployed as the only choice of survival.

5.4 Demand on Manufacture

Table 7, below shows the yearly demand of Peugeot cars from 1986 to 1993 at SCOA Motors, Kaduna Branch.

Table 7

Annual Sales of Peugeot Cars

Year	Total Sales	Decrease in Sales (%)
1986	314	-
1987	301	4.3
1988	292	3.1
1989	277	5.4
1990	269	3.0
1991	246	8.9
1992	211	16.6
1993	193	9.3

Source: Personal Survey

Prior to 1992 when the full deregulation of Forex market was adopted, branch recorded continous decrease in number of cars purchased by customers. This is evidenced from table 7, as the number of cars sold in 1986 decreased from 314 to 216 in 1991. Also sales of cars decreased from 211 in 1992 to 193 in 1993. Higher percentage decrease of 16.6 and 9.3 were record for 1992 and 1993 respectively when compared to the other period, either 1986 - 1991.

Furthermore, 12.9 per cent was the average percentage decrease in sale in period 1992 - 1993 while average decrease in sale in period 1986 - 1991 was 4.9 per cent.

The average decrease in sales in period of full deregulation of forex was significantly higher than the other period.

This new policy measure for sale and purchase of forex continued to depress demand for peugeot cars by customers. It was also gathered that 75 per cent buyers of peugeot series are Federal, State and Local Government while individual buyers are 25 per cent. The major buyers buy these products as a result of government which compelled all levels of government to use these

vehicles as official cars.

This decreasing trend in sales was as a result of hike in prices of vehicles by PAN. The increase in prices was the only survival strategy option available for the industry to stay afloat, in face of high cost of imported inputs induced by the continous depreciation of naira. Also, high cost of fund and substantial increase in working capital to finance the current operation of the industry.

CHAPTER 6

SUMMARY, CONCLUSION AND RECOMMENDATION

Since the adoption of economic reform programme in 1986, gradual deregulation of the forex market continued to have most significant effects on both the financial and manufacturing sectors of the economy. In pursuit of the objectives of exchange rate policy for deregulated forex market, the policy makers from time to time fine-tuned the mechanism for operating the market to make it more efficient. Thus, various measures and options have been adopted in the continued search for a realistic exchange rate for the naira.

On March 1992, a complete deregulation of forex market was adopted primarily to eliminate the observed distortions in the period of partial deregulations in the market. The objectives of this new policy include, to check malpractices of the authorised dealers which were channelling officially subsidied forex to parallel market, to close the gap between official and parallel market rates and allow the official rate of naira find its value against the parallel market value, to enhance the operational and allocative efficiency of forex market and to generate huge amount of money for government coffers by the removal of the subsidy on forex. Unfortunately,

these distortions re-emerged owing to fiscal inbalances and speculative activities.

As Financial Sector continued to withness a massive devaluation of naira, as the official rate of naira found it extremely difficult to find its value against the parallel market value and became more unstable. This instability of naira was traceable to inability of CBN to adequately fund the forex market. Furthermore, persistently large parallel market premium and its continued existence indicated misalighment of exchange rate and inefficiency in resource allocation, traceable to persistently large excess sdemand and entrenched interest. The closure of gap between the parallel and official rates remained elusive of the policy makers.

The unacceptably high interest rate structure were caused by the increase in the demand for funds for purchase of forex and mopping-up of fiscal deficit induced excess liquidity through the insuance of stabilization securities. These factors tended to put upward pressure on interest rates. This development was accentuated by oligopolistic structure of the banking system in which a few banks constitute the major suppliers of funds in the inter-bank market. The increase in number of distressed banks worsen the situation since such banks

tended to depend heavily on Inter-bank funds which attracted high interest rates. The demand gap initially decreased in the year 1992, but widened as a result of inflated demands for forex by unpatriotic banks from the official source.

In the face of these adverse effects of this new exchange rate system, competition against parallel market was greatly hampered as a result of too much documentary requirements and other restrictions which did not allow them to compete effectively. Competition among banks became keener than before especially when the confidence of customers in banking habit was eroded as a result of Frequent strikes, failure to meet their obligation, such as default in repayment of their deposits placed in some problematic banks on maturity and high incidence of fraud.

The manufacturing sector also experienced high cost of fund which was detrimental to investment in this sector. Accessibility of manufacturers to loanable fund was becoming more difficult since the bad debts of banks escalated as banks demanded high interest rates on previously existing loans. Since loan repayment was difficult, further loan advances to this sector might increase the debt burden, thus,

discouraging new investment spending on real assets such as plants and equipment. The massive devaluation of naira led to high cost of forex which continued to have negative effect on our manufacturing sector. Since most of inputs are imported. The hike in prices of manufactures was one of the survival strategies available to remain in business. Customers' reaction to hike in prices was decreased in demand. Thus the domestic price of manufacture remained unstable.

In conclusion, to achieve exchange rate stability which will foster the achievement of other macro-economic objectives, government should continue to encourage non-oil exports in order to boost supply of Forex through number of structures and incentives. Parallel market premium can be reduced to a manageable level by reducing documentary requirements and other restrictions in forex allocation in order to allow banks to compete effectively against parallel market premium. The banking system must be allowed to function on a commercial, largely market driven basis but with due guidance and supervision by the monetary authorities. Banks should also be patriotic and note that while deregulated interests provide the most transparent basis for price-based competition. Massive swings in interest rates

could produce strong political pressure to introduce interest rate controls. Banking sector should ensure that manufacturing sector is supported in the allocation of scarce resources in other to enhance the prospects for economic growth and employment. The rise in the number of distressed institutions and the rate of default in inter-bank transaction can be curbed. The appropriate authorities should intensify its efforts to rationalise and strengthen supervisionary function, in order to promote the efficiency, safety and soundness of the system. Liquidation of terminally distressed institutions ordered and loyal frame-work for debt recovery and credit enforcement through the exercise of legal remedies should be reviewed to ensure that culprits are effectively brought to book.

For attainment of price stability of manufacture, goods appropriate authorities, should fine-tune fical monetary interest and exchange policies in a manner that minimises inconsistencies and stems persistent depreciation of naira exchange rate and the attendant cost push inflationary tendency. Since the CBN cannot supply the total amount of forex requirements of this sector, manufacturers should be allowed to retain 100 per cent of their export proceeds in forex.

The government should encourage the growth of petrol-chemical industry which is the source of raw materials supplies to manufacturers. About 40 per cent of raw materials is petrol-chemical based and if petrol-chemical industries come on stream, most of the problems of manufacturers will be solved. The government should continue to encourage local sourcing of raw materials to reduce the need for forex for importation to the bearest minimum. Also, institute a machinery through which it will determine the actual forex requirements of manufacturers to check the excess that is bane in the system.

The cumbersome import process which mandate importers to open many forms M's and clevages attached with it. Making importation of raw materials cumbersome and difficult, also has resulted into phenomenal increase in prices of manufactures.

Government alone cannot be blamed for negative outcomes of the new exchange rate system, our drive to satisfy our individual selfish interests at detriment of our collective goal as a nation for a better tomorrow. There is a need for all to show some patriotism as citizens of this great nation.

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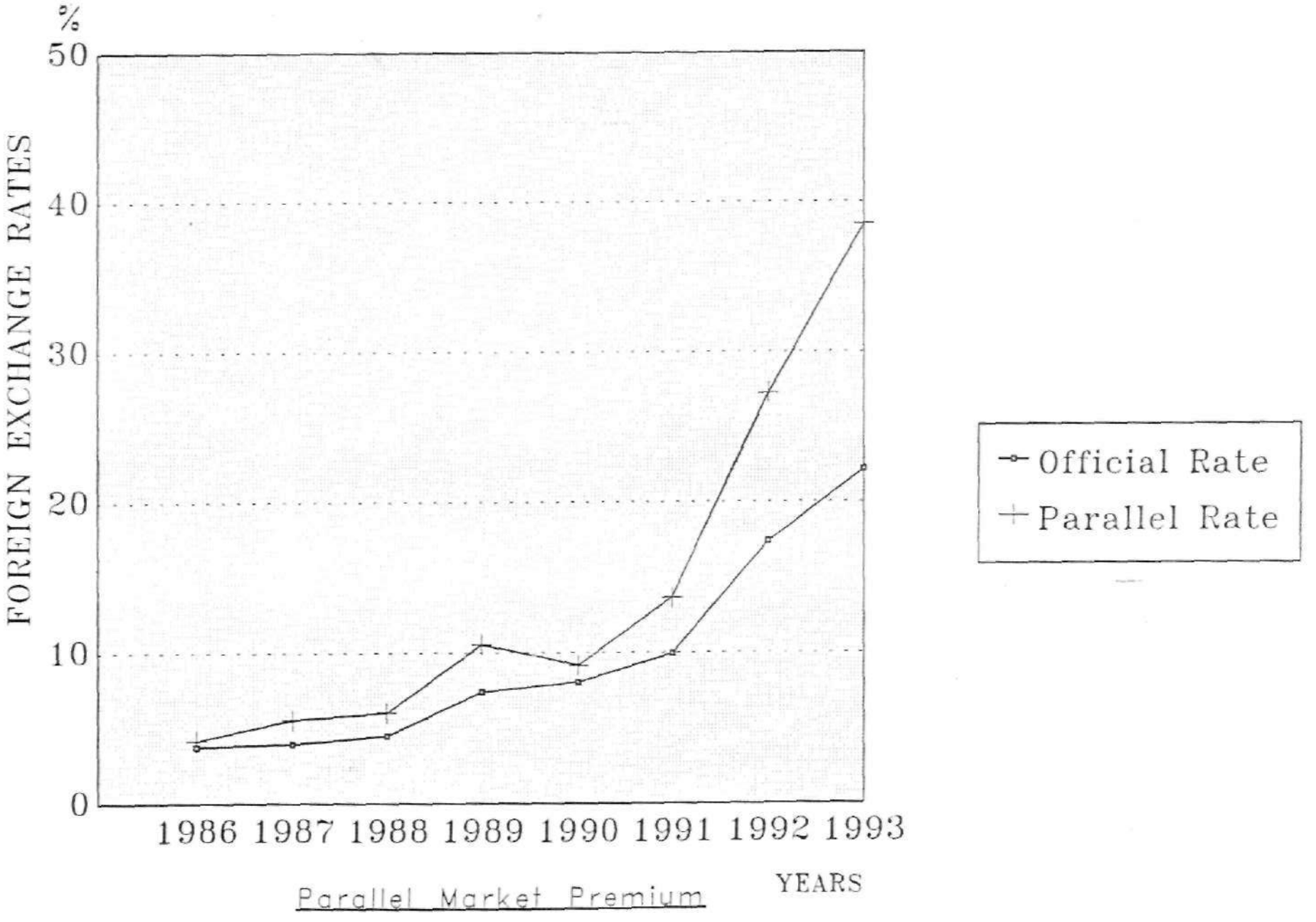
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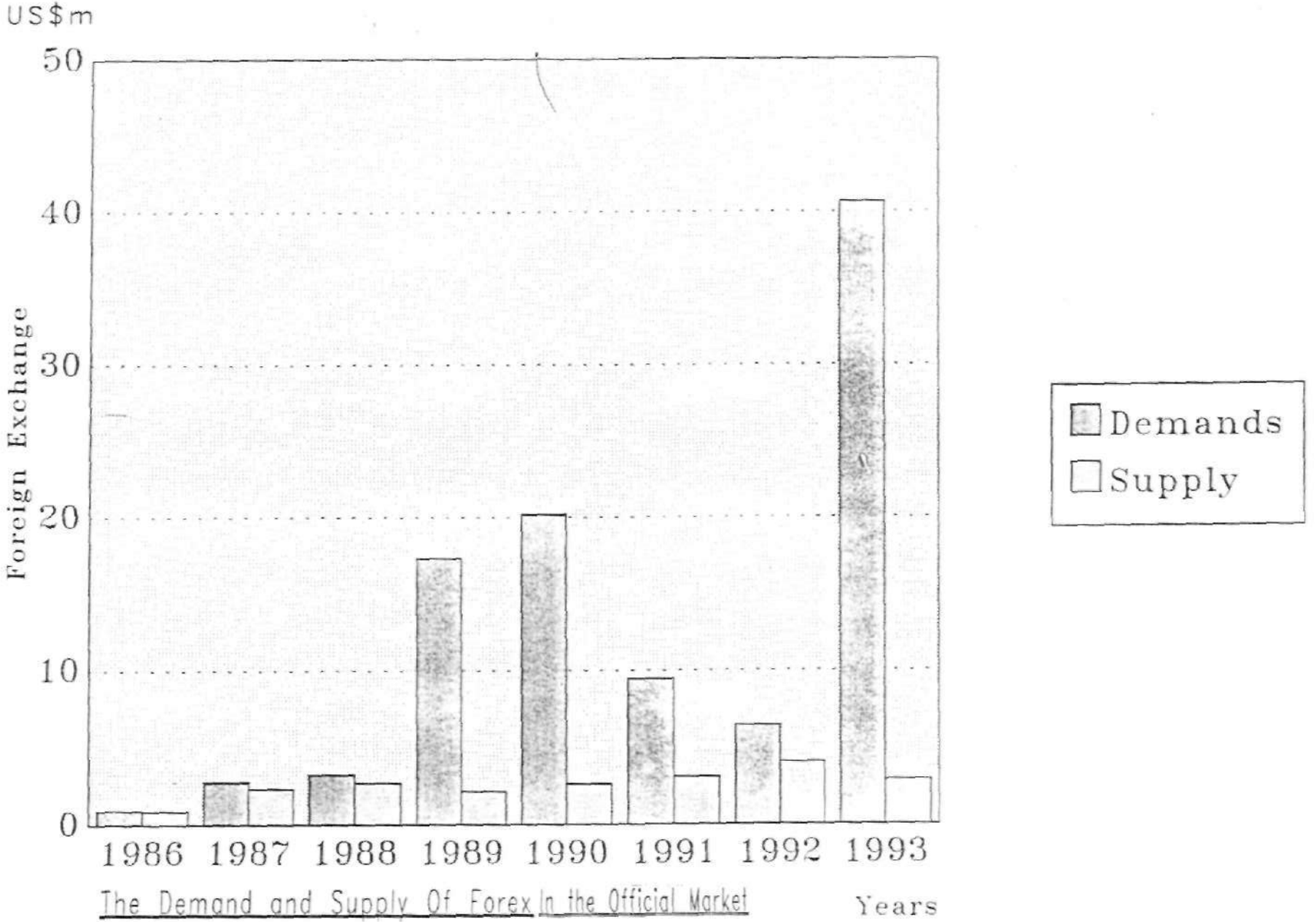
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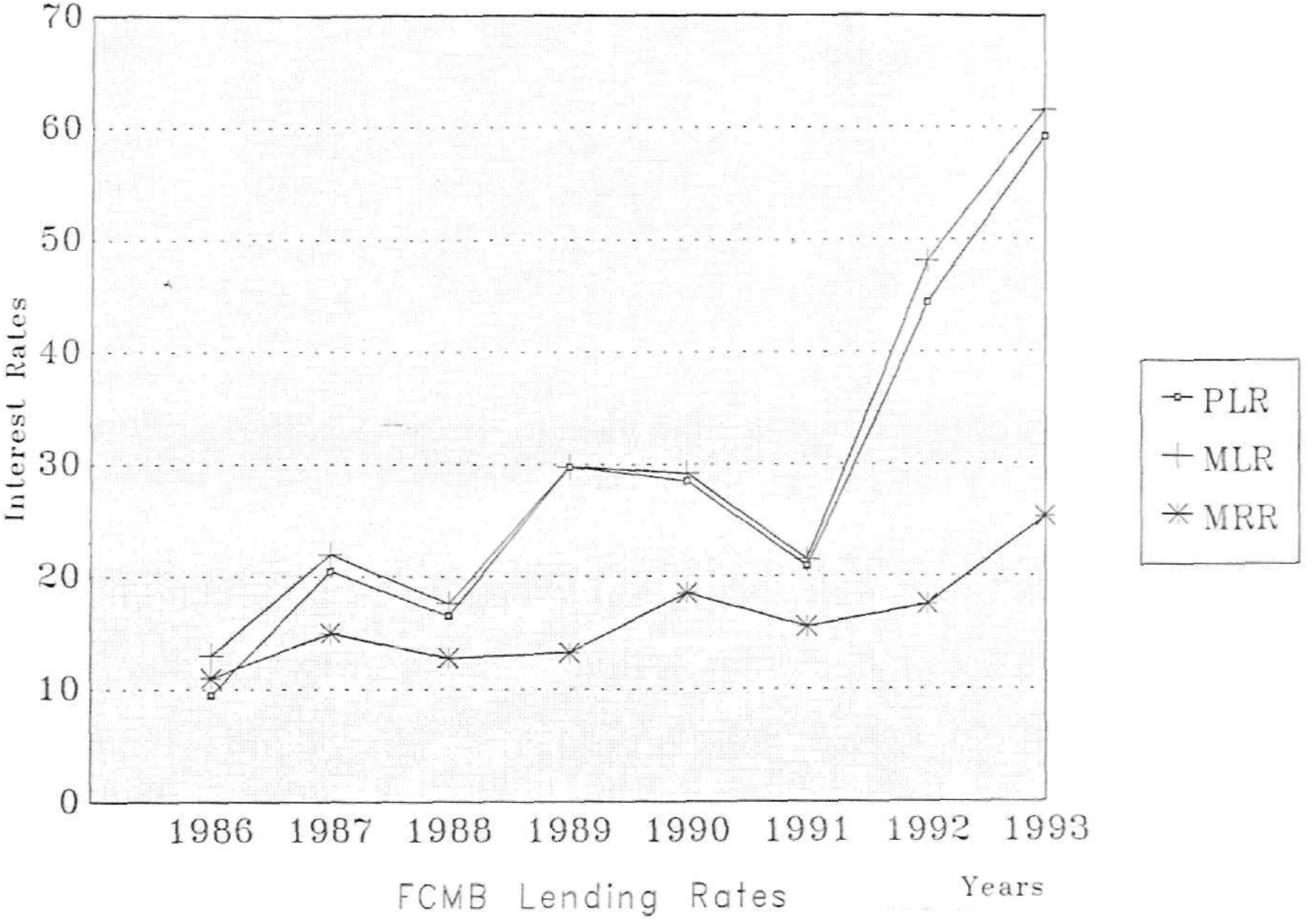
Parallel Market Premium

Fig. 1



The Demand and Supply Of Forex In the Official Market

Fig. 2



FCMB Lending Rates

Fig. 3