FOREIGN EXCHANGE MANAGEMENT IN NIGERIA CRITICAL APPRAISAL AND SUGGESTED POLICY MEASURES FOR THE FUTURE.

BY

DANIEL AUGOYE

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Z A R I A .

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DEDICATION:

TO MY WIFE

MRS JANET AUGOYE

For her encouragement and moral support throughout the period of the course.

DECLARATION

I hereby declare that all information used in this project were obtained from personal interviews and desk research. All consulted works have been duly acknowledged in the Bibliography.

Daniel Aregoye		12/3/97
Name of student	Signature	Date
M. I. F. OKEJI		4/5/98
Name of Supervisor	Signature	Date

CERTIFICATION

This project titled "Foreign Exchange Management in Nigeria, Critical Appraisal and suggested policy measures for the Future" meets the regulation governing the award of the Degree of Masters of Business Administration of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literacy presentation.

M. I. F. OKEJI 4/5/98

Name and Signature of Internal Examiner Date

....

Name and Signature of External Examiner Date

Abu-Abdessamad 4/5/98

Head of Department, Dept. of Bus. Admin. Date

.... 18/5/98

Dean, Post-Graduate School A.B.U. Zaria Date

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ABSTRACT

Foreign Exchange Management in Nigeria has been an issue and continues to be an issue that touches on the very foundation of the Economy since the movement of the Naira/Dollar Exchange rate is the most important single factor influence prices output and emp1oyment.

Foreign Exchange Management until 1986 was based mainly on the exchange control act of 1962. About mid 1991 the W o r 1 d oil ma rket f rom where the bu1k o f t he nation & foreign exchange was earned started to collapse as a result of the sharp decline in the demand for crude oil. The development in the world oil market adversely affected the Nigerian economy. Crude oil prices which had peaked at US$40.00 per barrel in 1981 fell drastically to USS$29,,00 per barrel in 1933 and slumped to US$14.85 in 1986.

In 1986 the structural adjustment programme was introduced to turn around the economy. However by 1992 worried by the wide gap between the official and so called parallel market rates the government further devalued the Currency.

By 1994 economic and socio.....political changes in the economy led to the adoption of a fixed exchange rate; the naira was fixed at N2.1.9960 to one (1) U.S. Dollar. This did not also work so in 1995 the Government adopted guided deregulation policy in managing the nations foreign exchange resources.

The analysis above shows that the government especially in the last few years have not been able to adopt a very efficient and stable strate in foreign exchange management. Given this scenario a suggested efficient method of managing the nations foreign exchange resources becomes imperative hence this study!

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CHAPTER ONE

This study is concerned with Foreign Exchange Management in Nigeria during the period prior to and since the introduction of the structural adjustment programme (SAP). The control system introduced in the 1994 Budget and the guided deregulation policy introduced in the 1995 Budget would also be examined. The study will go further to outline the prospects for the future foreign exchange management. Suggestions for new policy measures would be offered and how the value of the Naira could be strengthened would be discussed.

This chapter discusses the problems of foreign exchange management in Nigeria. The justification for the study, the scope of the study, the problem statement and the objective of the study are outlined. The research methodology, the plan of study and the limitation of the study are also presented.

1.1 PROBLEMS OF FOREIGN EXCHANGE MANAGEMENT

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. It can be expended to settle international obligations. When foreign exchange expenditure is lower than foreign exchange receipts the surplus is added to reserves.

Foreign exchange management started with private sector management. During this period agricultural exports accounted for the bulk of foreign exchange receipts. Much problems were not associated with the management since holding of foreign exchange was largely private and diffused throughout the economy. The usual carefulness associated with private ownership of resources was displayed during this time. However, with the enactment of the exchange control act in 1962 and the centralisation of foreign exchange the government became actively involved in its management. From then problems started to rear their ugly head. The first major problem was lack of executive capacity to efficiently manage the substantial foreign exchange earned in the 1970's. During this period crude oil exports displaced agricultural exports as the nation's major foreign exchange earner. Within this period substantial reserves were accumulated but mismanagement and foreign exchange malpractice's drained all the reserves. The second major problem was that the exchange control regulations until 1986 had become progressively cumbersome to manage. In the process smuggling of currencies and commodities across the Nigerian border had been heightened. Importers routinely engaged themselves in over loading of invoices in an attempt to obtain foreign exchange beyond what should normally be due to them. Indeed all kinds of malpractices aimed at siphoning huge amounts of money out of the country became rampant. Highly sophisticated methods of falsification of claims have been adopted over the year.

Another problem brought about by exchange control regulations was the creation of supply bottlenecks in the country as manufacturers of consumer products often experience delays in remitting payments for their suppliers of raw materials and other intermediate goods. As a result sporadic shortages of essential consumer items had become a common feature of the national economic scene. Thus prices of basic commodities were often substantially higher than they should normally have been.

There was also the problem of corruption. This often involved officers that were expected to administer and enforce the regulations. It took the form of bribes and other gratifications by foreign exchange applicants to the officers so that their applications may be considered on time or that their false claims may not be queried. Thus the overall effectiveness of exchange control was substantially reduced as applications that otherwise ought to have been rejected were given approval for foreign exchange cover.

Apart from the use of exchange control regulations in the management of foreign exchange, other tools which included monetary and fiscal policies as well as exchange rate adjustment adopted by the government at various times had their own problems.

From 1986 till the end of 1993 the major problems associated with foreign exchange management included inability of the authorities to meet the demand of foreign exchange users thereby resulting in high cost of obtaining foreign exchange, fall in industrial capacity utilisation high level of unemployment and inflation. Others were problems arising from the implementation of tariff structure, the Debt conversation programme and the rescheduling of the debt stock. Apart from these problems which are still with us today, distress in the banking industry, continuos gap between demand and supply of foreign exchange, inefficiency in policy implementation as well as unnecessary speculation in the foreign exchange market continue to be devil the economy.

1-2 JUSTIFICATION FOR THE STUDY

The study is a contribution to the search for the most efficient way to manage the nations's foreign exchange resources to the benefit of all and sundry. The current trend whereby prices of goods, even wholly produced in the country are related to the movement of the Naira/dollar exchange rate has made it extremely necessary for a realistic value of the naira to be determined through prudent management of foreign exchange resources. Secondly, foreign exchange crises which this country has been facing since 1982 touches every facet of our national life so there is the need for an efficient management of these resources for the well being of every Nigerian. For instance the bulk of the industries currently source raw materials abroad and inadequate foreign exchange resources could adversely affect their operation and consequently the level of output, employment and prices. The study would find out why exchange control measures adopted before the commencement of structural adjustment programme (SAP) could not turn around the external sector of the economy especially since 1982.

It would also find out why the control system in foreign exchange management was replaced in 1986 with a market based system with the introduction of the structural adjustment programme. Thirdly, why many policy measures were constantly changed between 1986 till date especially the fixing of the Naira exchange rate at #21.9960 to one United States dollar (US$) in the 1994 budget and the adoption of the guided deregulations strategy in the 1995 Budget.

1-3 SCOPE OF THE STUDY:

- Foreign exchange management in the period before the Structural Adjustment Programme (SAP).
- Foreign exchange management under structural adjustment programme (1986-1993)
- Foreign Exchange Management 1994 Fixed Exchange Rate.
- Foreign Exchange Management guided Deregulation - 1995
- Appraisal of previous policies and suggested policy measure for the future.

1-4 STATEMENT OF THE PROBLEM:

It is an established fact that foreign exchange resources is a vital input in the developmental process of the country. As a developing country we import most of our goods especially plant and machinery, industrial raw materials and even food items.

Without foreign exchange almost all the industries currently operating in the country would have to fold up since they rely on the use of imported raw materials. This would through the multiplier effect adversely affect the level of prices output and employment. Nigeria has also contracted a number of debt obligations as a result of our trade with other countries. The external sources of our debt include the Paris club of creditors, representing official government creditors (for example, the United States of America, United Kingdom, Federal Republic of Germany, France, Canada): the London club of creditors (representing commercial banks spread all over the world), the multilateral creditors such as the World Bank, International Monetary Fund (IMF), Africal Development Bank (ADB) and European Investment Bank (EIB); promissory notes holders (creditors in respect of refinanced debts) and other bilateral creditors.

Without foreign exchange we would not be able to service these debts and eventually repay the principal loans. Inability to honour our debt obligations would not alone worsen our balance of payment situation it would also make it difficult to receive new credits for further development. Apart from that foreigners would avoid the country thereby depriving the country of foreign investment. We would not also be able to honour our international obligation as a member of International political organisations like U.N.O. O.A.U and the commonwealth. We would not also be able to contribute positively to peace keeping efforts outside the country. Socio-economic development in the country would be adversely affected. The Government would not be able to provide infrastructure facilities as well as maintain institutions like NEPA and NITEL which import bulk of their facilities from abroad.

Inspite of the recognition of the indispensability of foreign exchange resources, various measures adopted to manage these resources have not achieved the desired result. For instance why is the value of the Naira declining continuously despite the various measures to halt the decline, SFEM, FEM. Why are traders using the movement of the Naira/dollar exchange rate as a basis for price determination of their goods. Why, the use of two different major methods of foreign exchange management within a short period of two years i.e the fixed exchange rate policy of 1994 and the guided deregulation policy of 1995. Inspite of the above anomaly only a few major studies have been carried out so far to address the problems of foreign exchange management in Nigeria, hence the relevance of this study.

1-5 OBJECTIVE OF THE STUDY:

The major objectives of the study is to determine the most efficient way of managing the nation's foreign exchange resources in the light of the various policies implemented in the past. Additionally, the study has been designed to achieve the following specific objectives:-

- To describe and examine the structure of foreign exchange disbursement in the past.
- To describe and examine the demand side of foreign exchange management.
- To describe and examine the supply side of foreign exchange management.
- To describe and examine current foreign exchange management.
- To make policy recommendations with respect to efficient management of foreign exchange resources in the future.

1-6 RESEARCH METHODOLOGY

The Study Area

Banks and companies based in Kano have been selected for this study. A number of factors accounted for this choice. Firstly its proximity to the researcher. Secondly, it would reduce cost of financing the study, thirdly, Kano state is the second largest commercial city after Lagos some of the banks have their headquarters here and many industrial companies are based there. Moreover the bulk of the Lebanese community noted for their active participation in a nation's external economy are based there. Kano state is also an agricultural state with most of the nation's groundnut produced there. The people are mainly farmers and have to their advantage irrigational facilities.

SAMPLING PROCEDURE:

A sampling frame was established before selecting the sample size by identifying the banks that have foreign exchange departments and have been dealing in foreign exchange transactions since their inception. Banks considered for interview and questionnaire administration include First Bank of Nigeria Plc, United Bank for Africa Plc, Union Bank of Nigeria Plc, Afribank of Nigeria Limited, Bank of the North and Citizens Bank International.

DATA COLLECTION

Both primary and secondary Data would be used. Primary data would be collected through interviews and the administration of the attached questionnaire to both users of foreign exchange and the Banks. Secondary data would be collected from official reports studies and other publications which relate to the current study.

DATA ANALYSIS

Data collected would be analysed using simple statistical method.

PLAN OF THE STUDY

The first chapter discusses the problems of foreign exchange management and the justification for the study, it also discusses the scope of the study, the problem statement, the objective of the study and the research methodology. In chapter two exchange rates development in Nigeria is examined and various approaches of foreign exchange is also discussed. Chapter three examines foreign exchange management in the period before the structural adjustment programme. Chapter four discusses foreign exchange management under the structural adjustment programme 1986-1993.

Chapter five discusses foreign exchange management from 1994 to date. Most of the tables analysis and interpretation are dealt with in this chapter. Chapter six summarises the research findings make conclusion and suggestions based on the findings of the study.

LIMITATION OF THE STUDY

The under listed limitations were observed.

Most of the banks were suspicious of the real motive of the study. Some felt the study was an attempt to find out whether the banks judiciously used the foreign exchange resources purchased from official sources. Some banks refused blatantly to co-operate with me. Others directed me to the office of their managing director. Another limitation was the non-co-operative attitude of some of the users of foreign exchange. Some of the individuals approached refused to disclosed any information simply because they felt the questionnaire was a source of exposing any illegal transactions undertaken by them. Some of the companies even questioned the authority I had to obtain such information from them.

Finally, there is the possibility of biases arising from the attitude of the respondents or even the interviewer or due to faulty interviewing techniques.

CHAPTER TWO

LITERATURE REVIEW

This chapter reviews the available literature on foreign exchange management. Emphasis is placed on foreign exchange approaches, exchange rate development in Nigeria and leading issues in foreign exchange management.

2-1 Foreign exchange approaches

2-1-i Theoretical background.

Foreign exchange resources are derived and expended in the course of effecting economic transactions between the resident of one country and the rest of the world. In this sense there is a close link between foreign exchange transactions and the balance of payments. Whilst foreign exchange transactions reflect cash flows arising from international operations, the balance of payments look at the actual movement of goods, services and changes in financial assets and liabilities. The positions of foreign exchange reserves available to a country determines its ability to cope with temporary difficulties. The issues of foreign exchange management is discussed by many writers largely as the basis of the theoretical formulations of the approaches to the balance of payment. Three approaches as noted by Obaseki P.J. in his article published in Central Bank of Nigeria publications (Bullion, volume 29 March 1991) are identified namely, the elasticity approach, income absorption approach and the monetary approach.

2-1.2 THE ELASTICITY APPROACH

This approach analyses the effect of devaluation on the trade balance. The proponents of the approach advanced that with adequate downward adjustment of exchange rates, countries with balance of payments difficulties would be able to export more, import less and save some foreign exchange.

However this was based on rigid assumption of mass unemployment, perfectly elastic supplies an initial balanced growth and the assumption that the elasticity's of home and foreign demand for imports should exceed unity.

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In developing countries relative prices are not the sole determinant of international trade. We have other measure like exchange control which was the main focus of policy in Nigeria before the introduction of the structural adjustment programme in 1986. To that extent devaluation of the currency peers may not achieve the desired result. However, the elasticity approach prescribe complimentary fiscal/monetary policies which could be adopted in place of devaluation to achieve the desired result.

2-1.3 INCOME ABSORPTION APPROACH

The realisation that elasticities include both price and income influences shifted emphasis to the development of a frame work that relates income to expenditure by introducing income into the partial analysis of the elasticity approach. The popular identity of the absorption approach relates the trade balance to total output and total absorption for devaluation to improve the trade balance, output must be greater than absorption. This is because devaluation is supposed to reduce the external value of domestic money supply and the value of domestic spending.

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However if the demand for foreign exchange is accelerating and the monetary authorities continue to exchange domestic cash balances for foreign exchange by drawing down their international reserves, the foreign exchange situation will continue to be precarious. This approach acknowledges that under extreme circumstance, direct control measures could be applied to reduce foreign exchange disbursements. The income absorption approach was partially relied upon by the authorities to manage Nigeria's foreign exchange resources before SAP. However, large scale devaluation of the naira was not embarked upon until SAP came into place. Although the approach prescribes the use of exchange controls in extreme circumstances it was nevertheless a deliberate policy frame work since 1962.

2-1.4 <u>The Monetary Approach</u>

The monetary approach emphasized the role of money in shaping other aggregates that influence foreign exchange movement and international reserves.

This approach did not categorise expenditure like the income absorption approach. It sees income and aggregate expenditure as either the accumulation or decumulation of reserves assets. It therefore considers the overall reserves movement as the policy variable. This is unlike the other two approaches that concentrated on the trade balance. The monetary approach also disagrees with the assumption that monetary effects of surpluses or deficits in the balance of payments are sterlised by the monetary authorities. It holds that the inflow and outflow of foreign exchange associated with surpluses and deficits in the balance of payments are not immediately sterlised, hence they influence aggregate money supply. Furthermore, the monetary approach assumes that when the exchange rate is fixed, the monetary authorities can control the foreign or international reserves component of the monetary base through appropriate credit policies. On the other hand, under a floating exchange rate regime, money supply is exogenous and as such can be controlled.

The implication is that when exchange rate are fixed international reserves have to be adequate to protect such rates. Conversely when rates are allowed to float the need for reserves is diminished. The monetary approach prescribes the adoption of appropriate domestic monetary/fiscal policies in conjunction with exchange rate variation to achieve equilibrium, However it frowns at exchange rate volatility. What is clear from the above is that a mix of policies drawn from the various approaches have been applied to manage foreign exchange in Nigeria the elasticity approach emphasized expenditure switching policies while the income - absorption approach prescribed both expenditure switching and expenditure changing policies. On the other hand monetary approach favours reliance on expenditure changing policies.

2-2 EXCHANGE RATE DEVELOPMENT IN NIGERIA

An exchange rate is a numerical expression of the value of the currency of one country in terms of another currency at any given time. It can also be defined as the price of one currency in terms of another currency. Exchange rate is a strong economic indicator for assessing the overall performance of an economy. It is one of the macro-economic variables that reflects the strength or weakness of an economy. A persistently strong currency is a reflection of a strong economy while conversely a persistently weak currency is a reflection of a weak and vulnerable economy. Objectives of the exchange rates include the following, to promote as much smoothness or as little jerkiness as possible for those rates adjustment that take place in the sense of avoiding large forced movements in the market rates. It is also to promote minimum friction in the implementations of exchange rate adjustment by the action of national and international authorities. It is also to avoid large divergencies of exchange rate from long-term equilibrium rates. The main objective of the exchange policy in Nigeria now is to have a realistic exchange rate which would remove the existing distortions and disequilibrium in the external sector of the economy as well as ease our persistent balance of payment problems. Exchange rates determination has taken different forms. Firstly, we had the parity with the pound sterling. The Nigerian currency was pegged to the pound sterling on a 1:1 ratio from 1960 to 1973 when it was devalued by 10 percent and allowed to move independently of the sterling. Thereafter the naira was progressively appreciated to source imports cheaply to fund development projects.

2-2.1 **THE GOLD CONTENT APPROACH**

Before 1971 the parities of the naira vis-a-vis the pound sterling and the U.S. dollar were determined using the gold contents of the naira, the pound sterling and the U.S. dollar. The gold contents of the pound sterling and the U.S. dollar were divided into the gold contents of the naira in order to derive the value of the naira in terms of the pound sterling and the U.S. dollar. The calculation was done as set out below:-

Gold contents of the naira	1.24414 grams of fine gold
Gold contents of the pound sterling	2.13281 grams of fine gold.
Value of the naira vis-a-vis the pound sterling	$\frac{1.24414}{2.13281}$
	=0.5833 i.e. $0.5833
Gold contents of the naira	1.24424 grams of fine gold.
Gold contents of the U.S. dollar	0.818554 grams of fine gold
Value of the naira in terms of the U.S. dollar	$\frac{1.24414}{0.818554}$
	=1.5200 <u>i.e. $1.5200</u>

After December, 1971 when the United States of America abandoned her obligations to convert the U.S. dollar into gold all the currencies of the world were re-aligned. The value of the naira was adjusted in relation to the pound starlings or the U.S. dollar's performance against a basket of currencies which included the following:-

1/ Deutsche Mark D.M

2/ Swiss Franc S.F

3/ French Franc F.F

4/ Dutch Guilder D.G

5/ Japanese Yen J.Y

6/ Canadian dollar C$

If for example the pound sterling appreciates against the basket currencies by 1% point any day or week, this movement can be responded to by appreciating the preceding day's or week's $/naira rate by the same or less percentage point.

2-2.2 <u>THE MARKET BASKET APPROACH:</u>

A 'basket' method of calculating the exchange rates similar to the IMF standard method of SDR valuation was introduced in February 28, 1978 as an alternative to the Gold content approach. The basic objectives of this approach was to moderate the impact of external inflation on the domestic economy and to reflect on Nigeria's balance of payments situation. The seven currencies included in the basket with their assigned weights are as follows:-

i.	U. S. Dollar	(31.0)
ii.	Pound Sterling	(26.1)
iii.	Deutsche Mar	(17.7)
iv.	Japanese Yen	(10.3)
v.	French Franc	(8.2)
vi.	Dutch Guilder	(5.0)
vii.	Swiss Franch	(1.7)

The weights were based on the relative shares of the countries whose currencies were included in the basket in Nigerias 1976 total imports. Reflecting the fact that the bulk of Nigeria's external payment was still made in pound sterling and the U.S. dollar, the weights for the two currencies were consequently adjusted upwards. The currency units for #1 were calculated on the basis of average exchange rate for the U.S. dollar during September, 1977 of #1=US.$ 1.5352 and the cross rates between the U.S. dollar and the six currencies in the basket. The currency units as at the time were:-

U.S. Dollar	-0.574616
Pound sterling	-0.277527
Deutsche Mark	-0.762284
Japanese Yen	-50.93938

French Guilder	-0.228190
Swiss Franc	-0.074842

These currency units remained fixed over a period of time.

In calculating the U.S. dollar equivalent at any particular date we divide the currency unit of each of 7 currencies in the basket by their respective exchange rates in the world foreign exchange market for any given date. The summation of the U.S. dollar equivalent of the seven currencies on 30/9/77 was #1-US$1.5352 which was the base period exchange rate for the US. $/#. Similarly, the summation of the US. dollar equivalent of the basket of currencies on 28/3/80 was #1-US$1.6283 and 3/4/80 was #1=US. $1.6129 while in November, 1984 it was #1=US.$1.2701 using the market basket approach. The cross rates for the other currencies in the basket vis-a-vis the naira are calculated on the basis of the exchange rates between them and the US. $/# rate. For the purpose of illustration, see the table below Table 1.

TABLE 1

FIRST TIER EXCHANGE RATE AS AT 11TH AUGUST, 1986 THE BASKET APPROACH OF THE NAIRA EXCHANGE DETERMINATION REVISED IMPORT WEIGHTED BASE RATE OF #1.00 = $1.2701 AS AT NOVEMBER, 1984

CURRENCY {1}	CURRENCY UNIT {2}	EXCHANGE RATE FOR 4/8/86 {3}	U.S. DOLLAR EQUIVALENT {4}	EXCHANGE RATE FOR 8/8/86 {5}	U.S DOLLAR EQUIVALENT {6}
US. DOLLAR	0.371966	1	0.371966	1	0.37196[illegible]
POUND STERLING	0.265614	1.475	0.180077	1.481	0.17934[illegible]
DEUTSCHE MARK	0.62568	2.0865	0.299871	2.0745	0.30160[illegible]
JAPANESE YEN	30.350902	154.2	0.196828	54.8	0.19606[illegible]
FRENCH FRANC	0.888969	6.779	0.131136	6.7285	0.1321[illegible]
DUTCH GUILDER	0.095963	2.3505	0.40827	2.538	0.03781
SWISS FRANC	0.05025	1.675	0.03	1.675	0.03
			1.250705		1.248914
			0.847893		0.843291

SOURCE; FOREIGN OPERATIONS DEPARTMENT,

CBN

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1. To find the US dollar equivalent of each currency as stated in column

a/ Divide each currency unit in column (2) by the respective exchange rate in column (3)

b/ Summation of the US dollar equivalent in (i-vii) of column 4 is #1=US$1.250705

2. To find-£/# is $= \frac{1.250705}{1.4750}$

$=$ 31=F 0.847936

3. To find the cross rates of other currencies vis-a-vis the naira

i. DM/# is $\frac{20865}{1.250705}$ = #1=DM 1.6683

ii. Yen/# is $\frac{154.20}{1.250705}$ = #1=¥ 123.29

iii. FF/# is $\frac{6.7790}{1.250705}$ = #1=ff 5.4201

iv. DG/# is $\frac{2.3505}{1.250705}$ = #1=DG1.8793

v. SF/# is $\frac{1.6750}{1.250705}$ = SF 1.3392

2-2.3 **The Use of the Currency Intervention System (the U.S. dollar as currency of intervention)**

On October 3rd 1983 the IMF complained about the higher incidence in our Naira exchange rates quotation having risen above the stipulated 2% limit. Consequently the management of our foreign exchange resources evolved a system whereby the perennial problem being caused by arbitrary incidence in our Naira exchange rate quotation could be minimised or eliminated. In December, 1985 it was agreed that a one currency intervention system be adopted to solve once and for all the problem. With this system, the Naira exchange rate was quoted against a single intervention currency - dollar - reducing the degree of divergence and with nil arbitrage position vis-a-vis the U.S. dollar and the pound sterling. Although the incidence of arbitrage was wiped out the system had a disadvantage of making the naira to sink with the U.S. dollar or float with it as the case may be in the world foreign exchange market. The system in effect was maintaining the US $/# rate at a point of about $1.0004 and deriving the cross rates of other currency vis-a-vis the naira via such a quotation i.e. the other currency rates take one from such quoted U.S. dollar/Naira rates.

2-2.4 The crawling Peg

From 1984 to 1986 the country adopted a crawling peg system by relating the value of the naira to the pound sterling and the U.S. dollar as her two currencies of intervention. This was because the bulk of Nigeria's external payments was made in pound sterling and the US. dollar. From time to time the relative value of the naira vis-a-vis the pound sterling and the U.S. dollar was adjusted as necessary.

2-2.5 The second tier foreign exchange market. (SFEM)

This was adopted in 1986 in order to find a realistic value of the naira which was perceived to have been over valued. The second tier rate was determined by auction involving authorised dealers and the Central Bank of Nigeria. In the first two sessions of the SFEM, the average of successful bids of authorised dealers was used to determine the exchange rate. Allocations were made to banks on pre-determined quota basis. Due to the downward trend of the nominal exchange rate the average pricing method was abandoned in the third auction and the marginal rate was adopted. Under this method, the last successful bid determined the clearing price which was also the ruling rate. However the method did not succeed in entrenching professional discipline in the system as biddings appeared unrelated to market situations. To introduce professionalism into the bidding system the Dutch Auction system (DAS) was adopted in April, 1987 when individual bank rates were used to allocate foreign exchange up to the marginal rate which cleared the market.

Under the Dutch Auction system the marginal rate continued to be used to determine the successful bids but the successful banks were debited at their various bid rates plus 1% exchange equilisation levy. The system however created the problem of multiplicity of rates while the naira depreciated further. It should be noted that at the commencement of the SFEM a dual exchange rate system for the allocation of foreign exchange was adopted. Pre-SFEM or transitional transactions, debt service payments, contributions to international expenses were excluded from the SFEM and settled at the first-tier rate.

2-2.6 THE UNIFIED EXCHANGE RATE SYSTEM

The first and second tier markets were merged into an enlarged foreign market (FEM) in July 1987 and all transactions were subjected to market forces. The merger increased demand pressures and contributed to the persistent depreciation of the naira exchange rate between July and November, 1987. In 1988 the inter-bank market (where banks were allowed to transact official foreign exchange between themselves) was separated from the official market and an autonomous market for privately sourced foreign exchange emerged with its own independent rates. The autonomous market was highly destabilising as its rates depreciated continously. This resulted in its subsequent merger with the FEM to form the inter-bank foreign exchange market (IFEM) in January, 1989. The official exchange rate in this market again became highly depreciated and the parallel market premium was susbstantially reduced. Under this regime, the exchange rate was determined through one or more of the following methods - marginal rate pricing, average rate pricing, highest and lowest bid, weighted average pricing, average of successful bids and consideration of the developments in the exchange ratesof the major international currencies. Its unique feature was that auctions were held daily. To further reduce exchange rate instability the Central Bank of Nigeria modified the inter bank procedures in December, 1990 when the Dutch Auction System was re-introduced. The CBN. also introduced in August, 1991 the model weighted method of exchange rate determination under the new system the rates tending towards the mode were applied to determine the market exchange rate.

2-2.7 **Completely Deregulated Exchange Rate system:**

The Central Bank of Nigeria adopted a completely deregulated system of foreign exchange trading on March 5, 1992 as a solution to the persisten instability in foreign exchange market as reflected by the wide divergence of the rates between the official and the parallel markets. Against the background of macro-economic instability, low capacity utilisation, capital flight and speculative activity in foreign exchange market and persistent depreciation of the naira exchange rate, the Government pegged the naira exchange rate at 21.9960 to US$1.00. The pegging of the naira exchange rate created massive problems including a high rate of naira depreciation as well as wide gap between demand and supply of foreign exchange, diversion of foreign exchange purchase from official sources for sale at the parallel market. Furthermore some banks earned a lot of money by just buying from official sources and selling at high premium to foreign exchange users. The pegging also made many manufacturers enjoy subsidy which they refused to pass to the consuming public in the form of cheaper prices of goods and services. The failure to achieve government objectives of fixed exchange rate led to the introduction of guided deregulation policy whereby the exchange rate is decided mainly by market forces and occasional intervention by CBN. to ensure stability in the market.

2-3 LEADING ISSUES IN FOREIGN EXCHANGE MANAGEMENT:

As stated by Mr. V.A. Odozi (Deputy Governor, CBN) in his paper published in Bullion July/Sept.1994 Edition; some of the leading issues include the following:

Exchange controls if properly designed and vigorously and serupulously implemented in a disciplined environment as emergency measures could make the desired impact in the short term. However, pursued beyond the short term, they are ineffective costly and engender unwholesome practices. On the other hand properly designed sequenced and rigorously pursued market-based reforms are more cost effective lower implementation cost, lower compliance cost, increased allocative efficiency and are ultimately the basis for launching an economy on a sustainable growth path. Secondly, deregulation does not imply the absence of controls, a laissez faire free for all regime as is often but unfairly charged by its opponents. Even in a deregulated environment there is scope for intervention in order to restore sanity and give direction and support to the market. In other words there are both theoretical and practical limits to deregulation. However, intervention should be reinforce not detract from underlying economic fundamentals as such an exercise would be futile. The failure to fully achieve the objectives of deregulation was not because of the inadequacy or inappropriateness of deregulation and policy strategy but because of faulty implementation. Indeed, the problem was failure to adjust rather than failure of adjustment. Thirdly, given the seriousness of the foreign exchange supply gap, more emphasis should be given to the enforcement of supply through appropriate incentives and the creation of an enabling policy and macro-economic environment. In this connection there is need to generate an exportable surplus and promote the export of resource based products where we do have dynamic comparative advantage sustained factor productivity enhancement and ouput growth and are also imperative. Moreover, the proposal for a second foreign exchange window needs to be actively pursued. Forthly, the 1994 budgetary measures were taken against a background of unsatisfactory economic performance and the clamour by many pressure grup including the organised private sector for the fixing of interest and exchange rates. Consequently the stated objectives of restoring macro-economic stability and the channeling of available resources to the priority sectors of the economy were laudable and beyond reproach. Indeed the prevailing economic situation at the end of 1993 called for far reaching remedial action. However, there is a growing concern expecially among the same influential pressure groups which were the architects of the 1994 budgetary measures that the strategies adopted have not been the most optimal (therefore, disoptimal) even in the aggravated circumstance of the economy as at the end of 1993.

Fifthly, the need for a credible foreign exchange regime cannot be overstated, such a regime must satisfy the following requirement:-

a/ Transparency in the system for allocating foreign exchange

b/ Exchange rate realism and allocative efficiency

c/ Recognition of the constraints imposed by the low level of foreign exchange receipts, the need to balance the budget or at least to susbstantially reduce the budget deficit and of economic fundamentals.

d/ Consistency with the need to mobilise foreign exchange and overtime have an autonomous and self-supporting inter bank foreign exchange market outside the CBN.

e/ Promoting healthy competition and minimizing the potential for malpractices; and

f/ Credibility and sustainability of the foreign exchange regime.

Sixthly, exchange rate stability could be achieved through a comprehensive policy frame work involving demand management, supply side initiatives and complementary measures. Fixing the exchange rate without the required complementary measures and fiscal discipline would be unavailing. Moreover exchange rate target zones which is a compromise between fixed and floating rates are also of no avail in the face of inadequacy of external reserves required to defend the currency parity and of fiscal imbalance.

Finally, in reality there is no substitute for robust, technically sound optimal and sustained policy regimes. There is also the need for flexibility and pragmatism, the need for appropriate and timely corrective action in the light of experience in order to avoid the shocks and high cost of long overdue adjustment.

CHAPTER THREE

PERIOD BEFORE THE STRUCTURAL ADJUSTMENT PROGRAMME (SAP)

Before the structural adjustment programme was introduced in 1986 foreign exchange management involved policy measures like exchange control regulation, export promotion and external reserves diversification. Trade and exchange controls were however the most prominent as they exerted direct impact on various aggregates in the economy. It should be noted that the exchange control act of 1962 which was reinforced by the Economic stabilization (temporary provision) act of 1982, formed the basic framework for foreign exchange management. The 1962 act made provisions for measures to increase foreign exchange resources, reduce the disbursement of foreign exchange and preserve the nation's internaitonal reserves. Other policies that were adopted were either in pursuance of the objectives of the 1962 act or meant to reinforce the providions of the act.

3-1 Trade and Exchange Controls:

Trade and exchange controls were meant to improve the balance of payment position and to maintain a level of reserves consistent with external stability. Also to maximise foreign exchange receipts from all available sources. Also to ensure optimal utilisation of foreign exchange resources and the enhancement of confidence in the external payment system in Nigeria by honouring international obligations subject to satisfactory documentation. The controls included quantitative restrictions in the form of imports and exports licensing requirement. Imposition of tariffs and restrictions on certain categories of imports and exports. The application of trade and exchange controls in Nigeria during this period were based on the need to tighten them during period of crises and loosen them during periods of relative ease. Thus from 1970 to 1975 and in 1980 controls were liberalised but tightened progressively from 1976 to 1979 and from 1981 to September, 1986 when the foreign exchange situation worsened and the pressure on the balance of payments persisted. This is shown on table 2 below:-

TABLE 2
FOREIGN EXCHANGE FLOWS THROUGH THE CENTRAL BANK OF NIGERIA
S' MILLION

YEAR	OIL	INFLOW NON OIL	TOTAL	VISIBLE IMPORT	OUTFLOW INVISIBLE	TOTAL	NET FLOW
1970	N.A	N.A	901.6	N.A	N.A	829.9	71.7
1971	N.A	N.A	1495.3	N.A	N.A	1315.6	179.7
1972	N.A	N.A	1818.5	N.A	N.A	1877.6	-59
1973	2605.6	793.7	3399.3	2483.8	272.1	2755.9	643.4
1974	7067.4	1374.8	8442.2	1260	2213	3473	4969.2
1975	7719.7	1197.6	8917.3	8844.2	115.3	8959.5	-42.2
1976	8698	1804	10502.6	8168.2	2846.1	11014.3	-511.7
1977	9975.9	2027.9	12003.8	10625.4	2182.1	12807.5	-803.7
1978	8287.5	4250.9	12538.4	11224	3505.1	14749.1	-2210.7
1979	14503.5	2847.5	17351	10764.9	3515.5	14280.4	3070.6
1980	22932.6	3046.7	25979.3	17815.9	3770.3	21586.2	-4393.1
1981	17471.5	3977.7	21449.2	22121.5	4322.3	26443.8	-4994.6
1982	12178.5	2772.7	14951.2	14245.3	2783.2	17028.5	-2077.3
1983	10192.5	1486.7	11679.2	7742	4353.6	12095.6	-416.4
1984	11016.1	1105.3	12121.4	6810.5	4846.4	11656.9	464.5
1985	11367.2	943	12310.2	5623.7	6107.6	11731.7	578.9
1986	5742.5	1234	6976.5	3114.8	3367.1	6481.9	722.2
1987	4659.3	851	5310	3945.1	1367.7	5312.8	197.5
1988	4924.9	304.3	5229.2	3347.5	2314.4	5561.9	-332.7
1989	5912.3	1072.4	6984.7	2202.3	3634.7	5837	1147.7
1990	7437.1	2125	9562.1	2508.3	4929.3	7437.6	2124.5

N.A NOT APPLICABLE **SOURCE; CENTRAL BANK OF NIGERIA**

As clearly seen in the table net flow was negative from 1976-1978 but positive in 1980. That year (1980) the Government adopted policy of massive trade and exchange control liberalisation as a result of the relatively comfortable position of foreign exchange resources in the preceeding year. The disastrous consequence of the policy led to the dramatic decline in foreign exchange reserves starting from the second half of 1981 which led to the enactment of the economic stabilisation (Temporary Provision) act in 1982. Control measures were progressively intensified up to June, 1986.

A major argument in favour of exchange control is their speed and flexibility. They can be introduced quickly and easily in response to an impending crises. Secondly, their effects can often be predictable as the controls attack the symptoms rather than the cause. They may also be used to encourage the domestic production of certain goods. The major short comings of the exchange control system was its inability to achieve internal balance in the short term and guarantee external equilibrium in the long term. Over evaluation of the currency under the system was a major obstacle that made the achievement of an internal balance difficult. Specifically the problems with the administration of exchange control system can be summarised as increased dependency on imports, deflation of external reserves encouragement of parallel market activities reduced capital in flow and the inability to pay on current basis. This led to the accumulation of payment arrears which compounded the external debt problem.

This is shown in table 3 below

TABLE 3
SELECTED EXTERNAL SECTOR VARIABLES
N' MILLION

PERIOD	EXTERNAL DEBT OUTSTANDING	DEBT SERVICE	EXPORT	IMPORT	EXTERNAL RESERVES	MONTHLY IMPORTS	AVERAGE MONTHLY IMPORT	NO. OF SERVICE RATIO	DEBT BALANCE OF PAYMENT	AVERAGE OVERALL RATE $=#1.00
1970	488.8	31	885.4	756.4	156.4	63	25	3.5	58.6	14000
1971	214.5	29.9	1293.4	1078.9	281.4	89.9	3.1	2.3	127.8	1.44
1972	263.4	26.2	1434.2	990.1	243.6	82.5	2.9	1.9	-39.6	1.52
1973	276.9	30.8	2278.4	1224.8	378	102.1	3.7	1.4	-174.4	1.52
1974	322.4	29.1	5794.8	1737.3	3460.8	144.8	23.9	0.5	3102.2	1.5891
1975	349.9	32.7	4925.5	3721.5	3380.1	310.1	10.9	0.7	157.5	1.6244
1976	374.6	34.4	6751.1	5148.5	3057.6	429	7.1	0.5	-339.9	1.596
1977	496.9	25.6	7630.7	7093.8	2518.7	591.1	4.3	0.4	527.2	1.5466
1978	1252.1	160.8	6064.4	8211.7	1192.5	684.3	1.7	2.7	-1293.6	1.6482
1979	1611.5	182.9	10836.8	7472.5	3043	622.7	4.9	1.7	1868.9	1.6591
1980	1866.8	101.6	14186.7	9095.6	5445.2	758	7.2	0.8	2402.2	1.8286
1981	2331.2	518.6	11023.3	12719.8	2424.8	1060	2.3	4.7	-3020.8	1.6534
1982	8819.4	775.2	8722.5	12565.5	1026.5	1047.1	1	8.9	-1398.3	1.4856
1983	10577.7	1335.2	7612.3	9723	725.2	810.2	0.9	17.5	-301.3	1.3822
1984	14536.6	2640.5	9088	7178.3	1080	598.2	1.8	29	354.8	1.3085
1985	17290.6	3718	11720.8	7062.6	1641.1	588.5	2.9	31.7	349.1	1.1206
1986	41451.9	2502.2	8920.5	5983.6	3587.4	498.6	7.2	28	-796.4	0.7866
1987	100789.1	3590.6	30239.9	17861.7	4643.7	1488.5	3.1	11.9	159.2	0.2519
1988	146076.4	8012.5	31129.8	21445.7	3272.7	1787.1	1.8	25.7	-2294.1	0.2204
1989	241393.6	13382	57971.2	30860.2	13457.1	3809.8	9.2	33.1	18498.2	0.1244
1990	297894.3	34414.6	109886.1	45717.9	34953.1	3809.8	9.2	33.1	18498.2	0.1244

SOURCE; FEDRAL MINISTRY OF FINANCE AND CBN DATA ON OUTSTANDING DEBT

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3-2 EXPORT PROMOTION

Within the period the government introduced many measures to boost exports since they constitute a major determinant of foreign exchange inflow. There was the export promotion council decree 1976. This was promulgated to give legal backing to ad hoc incentives already in place. The decree created the export promotion council and charged it with the promotion of Nigeria's non-oil exports and the diversification of the export base. Also the marketing boards were dissolved and replaced with commodity boards in 1977 in order to boost the export of Nigeria's scheduled export commodities. Other incentives introduced by the government included arrangements for setting up export free zones. There were concessions to exporters to retain 25 percent of their export proceeds. Exports and import procedures were liberalised and also the provision for the establishment of an export credit guarantee and insurance scheme. However, most of the key incentives to promote non-oil exports during the review period were not implemented. After attaining a peak of #14.2 billion in 1980 exports declined to an average of #9.5 billion in 1981-85 inspite of the stringent controls and efforts to boost export promotion. This shown in table 4 below.

TABLE 4
NIGERIA'S EXPORT
N' MILLION

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
TOTAL EXPORT	14186.7	11023.3	8206.4	7502.5	9088	11720.8	8920.5	30360.6	31192.8	61971.2	109856.1	121533.7	205603.1
OIL SECTOR C/OIL	13832.3	10680.5	8003.2	7201.2	8840.6	11223.7	8368.5	28208.6	28435.4	56106.8	109526.5	116856.5	201384.8
NON OIL SECTOR	554.4	342.8	203.2	301.3	247.4	497.1	562	2152	2757.4	2954.4	3259.6	4077.2	4228.3
SHARE OF TOTAL EXP	96.1	96.9	97.5	95.9	97.3	95.5	93.8	92.9	91.2	94.9	97.8	96	97.9
SHARE OF TOTAL EXP NON OIL	3.9	3.1	2.5	4.1	2.7	4.5	6.2	7.1	8.8	5.1	2.1	4	2.1
AVERAGE GROWTH RATES (TOTAL EXP)	30.9	22.3	25.5	8.6	21.1	28.9	23.9	240.3	2.7	85.8	89.6	10.6	69.2
AVERAGE GROWTH RATES (OIL SECTOR)	34.1	21.7	25.1	10	22.8	26.9	25.4	237.1	0.8	93.5	93.8	9.6	72.3
EXPORT OF MAJOR COMM. (COCOA)	311.1	142.7	150.4	226.2	182.8	182.1	370.7	1497.7	1475.9	1043.5	1047	1246.1	1564.8
EXPORT OF MAJOR COMM. (G/NUT)				1.3	0.2	1.5	0.1	2.1	1.4	1.6	1.4	2.5	3.5
EXPORT OF MAJOR COMM. (P/KERNNEL)	14.1	17.9	11.2	16.6	8.4	6.2	7.5	60.5	203.2	115.5	94.9	60.9	100.9
EXPORT OF MAJOR COMM. (RUBBER)	14.1	17.8	18	14.3	16.6	3.8	29.1	N.A	1.4	1.6	2.3	4.9	6.6
EXPORT OF MAJOR COMM. (TEN METAL)	14.2	26.8	N.A	N.A	N.A	4.1	1.3	30.2	8.7	5	6	10.5	11.5
OTHER EXPORTS	141.8	71.2	N.A	N.A	N.A	N.A	89.2	471.8	850.7	1093.3	1002.4	1127.4	1225.1

SOURCE; FEDRAL OFFICE OF STATISTICS

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3-3 External Reserve Diversification

Essentially reserves diversification is meant to optimally apportion a nation's reserves, assets among various reserve currencies to ensure maximum returns and minimise losses in case of fluctuation while at the same time ensuring that liquidity problems are minimised in daily foreign exchange transactions. Encouraged by the increase in reserves position due to favourable oil prices in 1974 the Central Bank of Nigeria on behalf of the government embarked upon active portfolio management by inaugurating an investment management committee in December, 1974. The deliberations of the committee were influenced by the breakdown of the Bretton-woods Agreement which resulted in the floatation of currencies without stand by arrangement to shore up their values when the need arose. Mainly as a result of the work of the committee Nigerian's foreign assets were completely diversified into several strong currencies by 1976. Major policy goals pursued during the mid-80's were to diversify external reserves, in view of dwindling foreign exchange receipts, in order to reduce the costs of conversion from one currency to another, while securing the adequacy of the reserves. Also the Central Bank's policy on holding external reserves shifted in favour of the relative strengths of currencies rather than the pattern of trade with Nigeria's trading partners. Nigeria's foreign exchange reserves which were held in four currencies hitherto were diversified into nine in 1976 as a result of increased oil receipts par of the reserves which were held in sterling were redistributed to other currencies in that year and sterling ceased to be the major components of Nigeria's foreign exchange reserves. See the table below

COMPONENTS OF NIGERIA'S EXTERNAL RESERVES

TABLE 5
COMPONENTS OF NIGERIA'S EXTERNAL RESERVES
(PERCENT)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Gold IMF Gold French and oil Facility	15.4	7.9	9.6	10.7	1.1	1.2	1.4	1.3	27.1	7.8	2.6	10	1.8	2.4	6.5	1.1	0.5	0.4	0.5	0.2	0.1
SDRS	-	7.9	13.4	9.5	1.1	1.2	1.7	2.2	4.6	2.6	3.6	11.3	2.7	10.2	0.5	0.5	-	-	-	-	-
Sterling Assets	75.4	73.9	54	59.1	57.6	33.1	14.7	16.5	14	4.9	22	15.1	18.8	17.3	16.6	7.1	4.9	9.1	5.8	21.9	42.5
US & Assets	9.2	10.3	23	20.4	38.8	41.8	20.9	15.8	14.6	25.3	23.5	19.7	39	33.9	51.2	58.2	76.2	69.6	66.6	67.3	50.4
DM Assets	-	-	-	0.3	1.3	12.5	26.6	30.5	14.8	37.1	22.8	13.2	6.3	5.4	6.9	6.2	5.4	5	9.1	2.9	0.4
French Franc	-	-	-	-	0.1	3.9	6	4	5	7.7	6.8	4.5	13.3	1.1	0.2	9.3	3.5	8	5	5.8	5.6
Canadian Dollar	-	-	-	-	-	-	15	12.7	2.1	2	1.4	2.1	1	0.9	0.6	6	0.3	0.2	0.2	-	-
Japenese Yen	-	-	-	-	-	-	7.3	9.2	4.5	5.8	9.1	9.6	0.5	0.3	-	1.3	-	-	-	-	0.1
Swiss Francs	-	-	-	-	-	-	1.5	1.9	-	6.4	6.8	9.4	12.8	23.4	12.4	12.5	3.3	2.7	3.4	0.4	-
Belgian Francs	-	-	-	-	-	-	3.5	3.9	9.2	0.3	0.8	1.5	3.1	3.8	1.8	0.4	0.2	0.4	0.6	0.1	-
Dutch Guilder	-	-	-	-	-	-	1.4	1.4	1.8	2.5	0.6	2.7	1.7	1.9	2	1.9	3.4	2.5	3.7	0.3	-
Others	-	-	-	-	-	-		0.6	2.3	2.4	-	0.9	-	-	1.3	0.9	2.3	2.1	5.1	1.1	0.9

SOURCE; CENTRAL BANK OF NIGERIA

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Diversification consequently became a very important policy of foreign exchange management. With the continuos rise in the strength of the U.S. dollar most of the external reserves were held in that currency. Thus external assets denominated in U.S. dollar moved from 20.9 percent in 1976 to 76.2 percent ten year later (1986). The sterling assets decreased from 15.0 percent in 1976 to 5.0 percent in 1986.

3-4 **Other tools of foreign exchange management during this period included external debt and exchange rate management.**

External debt management is a conscious and carefully planned schedule of the acquisition, deployment and retirement of loans acquired either for developmental purposes or to support the balance of payments. Before 1982 external debt management did not constitute a major problem for the overall management of foreign exchange resources. The ratio in fact reduce from 9.4 percent of the GDP. to 1.7 percent in 1975. However, after 1980 the external debt and the debt to GDP ratio rose rapidly. The ratio which was only 3.8 percent in 1980 rose to 23.3 percent in 1982 due to the inability to finance payment on current basis.

During this period the exchange rate was administratively determined. However, by 1981 a policy of gradual depreciation was embarked upon. The policy was meant to increase foreign exchange receipts through increased export volume and value, stem the outflow of foreign exchange and reduce the pressure on the balance of payments. During the period of administrative management of the naira and particularly between 1978 and 1985 the Central Bank used a basket of currencies.

CHAPTER FOUR

STRUCTURAL ADJUSTMENT PROGRAMME PERIOD - 1986 - 1993

4-1 Process of Deregulation

4-2 Policy Measures - SFEM, FEM

4-3 March 5 1992 Deregulation of the foreign exchange market

4-4 Export Promotion

4-5 External Debt Management.

4-1 Process of Deregulation

The process of deregulation really started with the foreign exchange crises that erupted in 1982 as a result of the oil glut of the preceeding year. The nation had accumulated payment arrears that could not be settled as a result of declining foreign exchange earnings. The situation thus reached a critical level. There was panic in the entire system. Letters of credit already confirmed were recalled by the Central Bank of Nigeria and banks were disallowed from opening new ones since many countries refused to extend further credit to Nigeria that time.

The international community also stopped guaranteeing imports coming into Nigeria. The foreign exchange situation was very tight and exchange control measures were reactivated and made more stringent. Some of the measures were advance deposit requirements for a large number of imports. These measures in addition to the scarcity of foreign exchange increased activities in the foreign exchange market. The activities of speculators and numerous middlemen increased during the period. The increasing demand for foreign exchange at a time when the supply was shrinking also encouraged the development of a flourishing parallel market for foreign exchange. Although the exchange control system continued to be applied to allocate foreign exchange attempts were made to depreciate the exchange rate to reduce pressure on the external sector, when it became clear that it was over valued. The parallel market premium that emerged over time as a result of the disequilibrium in the official foreign exchange market led to various abuses including under invoicing of exports and over invoicing imports. It also led to capital flight and diversion of official foreign exchange resources into the parallel market. The exchange control system was unable to evolve an appropriate mechanism for foreign exchange allocation in consonance with the goal of internal balance. In fact right from 1982 the economy had been under persistent pressure leading to a general recession. Domestic inflation kept on rising from 7.7 percent in 1982 to 39.9 percent in 1984. In the external sector the continuos pressure on the balance of payments led to a deflation of the reserves from #2.4 billion in 1981 to #798.5 million in 1983. Consequent upon dwindling oil receipts, the external payments situation became so critical that some trade arrears had to be refinanced. In order to establish a conducive atmosphere suitable for effective execution of economic policies against a background of relaxed and stable foreign exchange the President in his speech on 27th June, 1986 announced the decision of government to establish the second tier foreign exchange market (SFEM). The main objective included the following:-

- The determination of a realistic exchange rate for the naira through the operation of market forces of supply and demand and
- The provision of a forum for the rational allocation of scare foreign exchange resources.

SFEM was a part of the structural Adjustment Programme (SAP) - a policy aimed at rejuvenating the economy. Objectives of SAP included the following:-

(1) the adoption of realistic exchange rate policy through the establishment of the second tier foreign exchange market.

(2) Adoption of measure to stimulate domestic production and broaden the supply base of the economy.

(3) Rationalisation of the customs tariff in order to promote domestic production.

(4) Trade and exchange liberalisation in order to enhance efficiency and minimise malpractices.

(5) Adoption of appropriate pricing policies for public sector enterprises and

(6) Rationalisation and selective commercialisation/privatisation of public sector enterprises.

4-2 **Policy Measure - SFEM, FEM**

Second tier foreign exchange market was a major policy tool during this period in the management of the nation's foreign exchange resources. This basically was a market based mechanism for exchange rate determination. Through this the naira which was over valued before the introduction of SAP would have a realistic value and pressure on foreign exchange resources would reduce. In effect the exchange rate mechanism was expected to result in a more rational allocation and utilisation of foreign exchange resources and reduce foreign exchange volatility thus making foreign exchange management less difficult. The second tier foreign exchange market started with the first bidding session held on 26/9/86 in the Central Bank of Nigeria. On that date, the exchange rate in the first tier foreign exchange market was #1.5691 to 1 US dollar. The rate that emerged at the maiden session of the auction was #4.6174 to 1 US dollar. This showed a depreciation of about 166% when the two stated rates above are compared. The first and second tier market were merged into an enlarged foreign exchange market (FEM) in July 1987 and all transactions were subjected to market forces from 1987 until January 9 1989 when the Dutch Auction system was the principal tool of exchange rate determination in the FEM. Within this period and particularly at the end of 1988 there was an observed wide differential of about 55% between the FEM rate and the autonomous market rate. This led to the modification of foreign exchange market in 1989. The auction rate and the autonomous rate were fused together. The official exchange rate in the market again became highly depreciated and the parallel market premium was substantially reduced. Between March 1991 and February 1992 the management of the nation's foreign exchange resources involves occasional intervention of the foreign exchange market by the Central Bank of Nigeria in order to achieve the desired exchange rate.

TABLE 6
FOREX MARKET MARCH, 1991 - 26TH FEBRUARY, 1992

BILL NUMBER	DATE	EFFECTIVE RATE	SUPPLY (US $ MILLION	DEMAND (US & - MILLION)	AMOUNT TAKEN UP (US $ MILLION)	NO. OF PARTICIPATING BA BANKS	
						SUCCESFUL	UNSECCESF
21	15/3/91	10.0506	57.5	224.88	57.5	108	
22	22/3/91	9.0908	197.3	197.3	174.119	107	
23	27/3/91	8.7881	120	177.39	107.796	56	
24	3/4/91	8.7881	57.5	170.02	42.528	90	
25	10/4/91	8.7884	57.5	152.57	52.122	95	
26	17/4/91	8.8131	57.5	130.1	53.908	95	
27	24/4/91	9.0866	59.2	140.9	55.988	109	
28	3/5/91	9.2654	57.5	148.2	56.252	106	
29	8/5/91	9.239	62.112	141.7	61.491	105	
30	15/5/91	9.2971	57.5	171.4	55.502	102	
31	22/5/91	9.4949	57.5	163.8	56.925	104	
32	29/5/91	9.697	57.5	173	54.442	111	
33	5/6/91	9.9403	57.7	183.3	52.5	103	
34	2/6/91	10.1869	60.49	210.7	57.586	107	
35	19/6/91	10.303	57.5	206.9	51.232	112	
36	3/7/91	10.5051	57.5	195.9	56.925	108	
37	10/7/91	10.7652	57.5	215	52.21	107	
38	17/7/91	11.0682	61.38	207.7	59.168	109	
39	24/7/91	10.7652	63.42	194.1	59.911	117	
40	31/7/91	11.3252	57.5	193.5	53.906	106	
41	7/8/91	11.6162	57.5	200.4	55.344	106	
42	14/8/91	11.9171	57.5	196.1	41.774	112	
43	14/8/91	11.4139	57.5	159.3	50.818	108	
44	21/8/91	11.1128	57.5	140.9	54.999	106	
45	28/8/91	10.8681	57.5	154.9	54.596	107	
46	4/9/91	10.6304	57.5	152.9	48.645	107	
47	11/9/91	10.3633	57.5	150.38	54.539	105	
48	18/9/91	10.114	57.5	145.9	57.241	107	
49	25/9/91	9.8585	57.5	153.6	57.265	116	
50	3/10/91	9.9596	57.5	154.7	56.58	114	
51	9/10/91	9.8587	57.5	165.4	57.04	113	
52	16/10/91	9.8587	57.5	187.3	57.128	116	
53	23/10/91	9.8642	57.5	192.8	56.522	116	
54	30/10/91	9.8611	57.5	174.7	56.724	115	
55	6/11/91	9.8628	57.5	179	57.448	110	

56	13/11/91	9.8682	57.5	206	46.003	NA	
57	20/11/91	9.8636	69.5	246.3	68.438	118	
58	4/12/91	9.8631	115	323.7	114.069	119	
59	11/12/91	9.8657	57.5	252	55.949	119	
60	18/12/91	9.8662	70	330	69.209	118	
61	8/1/92	9.4697	60	235.21	60	118	
62	22/1/92	9.5076	60	234.9	60	119	
63	29/1/92	9.7258	60	226.64	60	119	
64	5/2/92	10.0985	60	237.71	60	119	
65	12/2/92	10.2273	60	213.46	60	120	
66	19/2/92	10.3543	60	232.46	60	120	
67	26/2/92	10.3564	60	232.46	60	120	

SOURCE; CENTRAL BANK OF NIGERIA

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Despite the various interventions to achieve the desired exchange rate there was still a wide gap between the official and the parallel rates. This led to the abolition of the official rate and the complete deregulation of the foreign exchange market in March 1992.

4-3 MARCH 5 1992 DEREGULATION OF THE FOREIGN EXCHANGE MARKET.

On March 5 1992 Central Bank of Nigeria adopted a completely deregulated foreign exchange market in order to check the persistent instability in the market reflected by the wide divergence of the rates between the official and the parallel markets. The parallel market premium was as high as 79.2 percent in February 1992 compared with only 20 percent in 1990, 35.5 percent in 1991 and the international limit of 5.0 percent. Under the new arrangement the CBN buys and sells actively in the market and also supplies in full and requests for foreign exchange made on it by the authorised dealers. The aim of the new mechanism was to narrow the parallel market premium and enhance the operational and allocative efficiency of the foreign exchange market. The CBN adjusted the effective rate upward on March, 5 1992 to US $1.00 = #18.00 from #10.5564 the previous day. In addition it satisfied the demand of $400.0 million made by the authorised dealers. The upward adjustment of the official exchange rate reduced the parallel premium to 7.5 percent. The impact of this measure brought relative sanity into the market. Secondly, the government was able to realise more revenue from the same quantum of foreign exchange. Thirdly, the incidence of diversion of foreign exchange purchased from the official market to the parallel market reduced. In effect the March 5, 1992 deregulation brought about better management of the nation's foreign exchange resource.

4-4 EXPORT PROMOTION

This was one of the major policies aimed at increasing the supply of foreign exchange during this period. The emphasis was mainly on non-oil export sector. Licensing requirement for non-oil export was abolished in 1986 to encourage more people to go into the export business and thereby enhance non-oil receipts. Commodity boards were also abolished in 1986 to make non-oil export business more competitive. In addition the foreign domiciliary account scheme became operational. Under the scheme exporters retained 100 percent of their export proceeds in foreign currency accounts domiciled in Nigeria. To further boost non-oil exports, the Central Bank of Nigeria set up a rediscounting and refinancing facility (RRF) in 1987. Under the scheme banks that engage in export financing could recoup such funds from the

Central Bank at the minimum rediscount rate thus allowing them a margin over the commercial rates they charge exporters. The Government also continued with the policy of external reserves diversification in order to increase its earnings of foreign exchange.

4-5 EXTERNAL DEBT MANAGEMENT.

This was one of the most important demand management measures adopted during this period. The objective was to stream line the demand for foreign exchange by curtailing foreign exchange expenditure. New external borrowings were restricted to key projects and a debt conversion programme was introduced in 1988 to further reduce the debt stock. In addition various debt rescheduling agreements were concluded with the London and Paris clubs of creditors. To reduce short-term fluctuations and instability in the foreign exchange market, tight monetary credit and fiscal policies were introduced by the Government during this period. For instance Government directed its agencies to transfer their deposits from the banks to the Central Bank in 1989. The tariff structure was also re-aligned to reduce the importation of non-essential items. The practice whereby loan beneficiaries guaranteed such loans with foreign securities was also prohibited and loans already granted under the scheme were recalled. In addition, the mopping up of excess liquidity from the banking system in order to reduce demand pressures and ultimately the demand for foreign exchange continued.

CHAPTER FIVE

FOREIGN EXCHANGE MANAGEMENT 1994 TO DATE

5-1 1994 BUDGET - FIXED EXCHANGE RATE

5-2 1995 BUDGET - GUIDED DEREGULATION

5-1 **1994 BUDGET-FIXED EXCHANGE RATE**

As noted by Mr. V.A. Odozi Deputy Governor, Central Bank of Nigeria in his article in Bullion July/September, 1994 edition; broad objective of the 1994 budget wee the achievement of exchange rate stability and the channelling of the bulk of available foreign exchange to the priority sectors of the economy at an affordable cost in order to stimulate economic growth. This was against the background of macro economic instability low capacity utilisation, capital flight speculative activities in the foreign exchange market and persistent depreciation of the naira exchange rate experienced at the end of 1993. The Naira exchange rate was pegged at #21.9960 to US $1.00 while the lending rate was capped at 21%. Demand management and supply enhancing measures were introduced for the purpose of achieving the objectives of the policy. The demand management measures included the abolition of financing of imports on the basis of Open Accounts and Bills for collection, more stringent import surveillance, tariff measure, effective duty collection, mandatory sectoral allocation of foreign exchange to end users (whose requests were to be fully backed up by naira deposits), the pursuit of fiscal viability and monetary restraint and the retention of existing measures. The supply enhancing measures included the pooling of all public and private sector foreign exchange receipts and their centralisation in the Central Bank.

Under the 1994 arrangement 15% of the foreign exchange available for the forthrightly allocation was set aside for the importation/production of priority items as determined by the foreign exchange allocation committee while the balance of 85% was allocated as follows:-

Manufacturing	-	60%
Agriculture	-	10%
Finished goods	-	20%
Invisible	-	10%

To complement the foreign exchange management measures parallel market activities were declared illegal.

5-1.1 **Fixed Exchange Rate - Foreign Exchange End Users.**

Individual users of foreign exchange complained of inability to source foreign exchange from the banks in Kano. Only about 20% of those interviewed were able to buy foreign exchange from their banks during the period under review. On the other hand corporate users like Dantata and SAWOE, Danji pharmaceuticals and most of the manufacturing companies had easy access to foreign exchange available in the banks in Kano.

TABLE 7

ACCESSIBILITY TO FOREIGN EXCHANGE IN KANO STATE.

END USER	NO. OF RESPONDENT	THROUGH BANKS (OFFICIALS)	PARALLEL MARKET
Individual	20	20%	80%
Corporate Bodies	20	65%	35%

source field survey

A close observation of the table shows that individuals obtained a small percentage of their foreign exchange needs from the banks. They gave reasons like discriminatory policies, bureaucratic control unnecessary documentation as militating factors that made them avoid the banks. However, they admitted that they would have preferred obtaining all their foreign exchange needs if the banks had not discriminated against them.

On the fixed exchange rate policy individual users interviewed felt that the policy was not an efficient method of managing the nation's foreign exchange resources. They argued that it discouraged those who have foreign exchange abroad from bringing it into the country because of the cheap rate they are compelled to sell to the Central Bank of Nigeria. Furthermore they said the gains of exchange rate determination through market forces are eroded through the fixing of the naira exchange rate.

On the other hand corporate bodies especially manufacturing firms interviewed spoke in favour of the fixed exchange rate. They however felt that the percentage of foreign exchange allocated to the manufacturing sector should be increased. They also called for an increase in the supply of foreign exchange to the market. Furthermore they said the Government should exercise restraint in the use of deficit financing since this weakens the domestics currency especially where it is not matched with corresponding production of goods and services.

5-1-2 **Banks View on the Fixed Exchange Rate**

Some of the bank officials interviewed spoke against the fixed exchange rate. They argued that the practice encouraged manufacturers and businessmen to make enormous profit at the expense of the interest of the economy. They also felt it encouraged banks to make substantial profits at the expense of the Government. They looked at the fixed exchange rate regime as encouraging banks to buy foreign exchange at a cheap rate in the official market and sell at exorbitant rate at the parallel market. In effect they concluded that it encouraged banks to engage in sharp practices.

Other bank officials interviewed expressed concern on the nation's reliance on oil as the only major source of foreign exchange earnings. Infact they decried the low percentage share of non-oil exports in total exports. The reflect the unhealthy situation.

TABLE 8
SHARE OF NON-OIL EXPORTS IN TOTAL EXPORTS
(PERCENT)

	1987	1988	1989	1990	1991	1992	1993	AVERA SHA
Agro Allied Product	6.6	6.2	3.2	1.5	2.2	1.4	1.8	
Cocoa	5	4.8	2	0.7	1.1	0.5	0.7	
Cocoa Product	0.4	0.2	0.2	0.1	0.1	0.1	0.1	
Palm Produce	0.4	0.2	0.2	0.1	0	0.1	0.1	
Rubber	0.3	0.5	0.5	0.3	0.5	0.4	0.4	
Wood Products	0.2	0	0	0	0.1	0.1	0	
Fish and Shirump	0.1	0.1	0.1	0.1	0.1	0.2	0.2	
Hides and Skins	0	0.2	0.1	0	0.1	0.1	0.1	
Coffee	0	0.2	0.1	0	0.1	0.1	0.1	
Ginger	0	0	0	0	-	0	0	
Gum Arabic	0.1	0	0	0	0	0	0	
Cotton	0	0	0	0	0.2	0.1	0	
Other Agric Products	0.1	0.1	0.1	0.1	0	0	0	
MINERALS	0	0.1	0	0	0.1	0	0	
Tin	0	0	0	0	0	-	0	
Other minerals	0	0.1	0	0	0	0	0	
MANUFACTURED GOODS	0.1	0.1	0.3	0.4	0.6	0.3	0.4	
Beer	0	0	0	0	0	0	0	
Soap and Detergents	0	-	0	-	0	0	0	
Textiles	0.1	0.1	0.2	0	0.3	0.1	0.1	
Plastics	0	0	0	0	0	0	0	
Louvres/Glass Sheets	-	-	-	-	-	-	0	
Urea Ammonia	-	-	-	0.1	0.3	0.2	0.3	
Vehicle	-	-	-	0	0	-	-	
Asbestor Cement	-	-	-	0	0	0	-	
Other Manufactures	0	0	0.1	0.2	0	0.1	0.1	
OTHER EXPORTS	0	0.6	0.5	0	0.9	0.1	0	
Scrap Metals	0	0	0	0	0	-	-	
Craft Rafia Baskets	-	0	0	0.3	0	-	-	
Miscellaneous	0	0.6	0.4	0	0.9	0.1	0	
TOTAL NON OIL EXPORTS	6.8	7	4.1	1.9	3.8	1.8	2.2	

SOURCE; DERIVED FROM TABLE 4

TK//

As shown in the table the percentage of total non-oil exports in the share of the nation's export in 1987 was 6.8 However, by 1993 the percentage had reduced to only 2.2 wearing that the nation virtually relies on oil export as the source of foreign exchange earnings.

TABLE 9

3 - 5 FOREIGN EXCHANGE FROM OFFICIAL SOURCES PROBLEMS STATED BY SAMPLED FOREIGN EXCHANGE USERS

All the respondent to the questionnaire acknowledged encountering problems in sourcing for foreign exchange from officials sources. This is reflected in the table below

PROBLEM ENCOUNTERED IN SOURCING FOR FOREIGN EXCHANGE FROM OFFICIAL SOURCES

PROBLEMS OF FOREIGN EXCHANGE	NUMBER INTER-VIEWED	NUMBER OF POSITIVE RESPONDENT	PERCENTAGE OF POSITIVE RESPONDENT
Inadequate supply of foreign exchange	25	24	96%
Delay in processing application	25	18	72%
Problems of documentation	25	15	60%
Delay in disbursing foreign exchange	25	20	80%

The table indicates that 96% of the surveyed people believed that inadequate supply of foreign exchange during this period made it difficult for the Government to implement its fixed exchange rate policy. As the surveyed foreign exchange users considered delay in processing applications for foreign exchange as well as delay in disbursing approved foreign exchange as other problems affecting the overall management of foreign exchange resources.

TABLE 10

5-1-4 PROVISION OF NAIRA COVER FOR FOREIGN EXCHANGE IN BANKS

FOREIGN EXCHANGE USERS	NUMBER OF RESPONDENT	NAIRA COVER FOR TRANSACTIONS
Individual	20	100%
Corporate Bodies	20	80%

Source: Field Survey.

The table indicates that for all transactions by individuals in 1994 the banks insisted on full payment of the naira cover for the desired foreign exchange for corporate bodies their transaction was covered on the average by 80% of naira deposits. This shows that the banks had much confidence on corporate bodies.

5-2 1995 BUDGET - GUIDED DEREGULATION POLICY

Against the background of persistent depreciation of the naira exchange rate in the parallel market sharp practices of banks and refusal of private owners of foreign exchange to sell to the Central Bank at ridiculously low rate and manufacturers inability to reflect the susbsidized foreign exchange in the form of low prices for consumer goods the Government adopted guided deregulation policy in the management of the nation's foreign exchange resources.

The adoption of this policy was also influenced by inadequate supply of foreign exchange. For instance out of the projected total foreign exchange receipts of $8131 million in 1994 only $6121.2 million was actually received. In line with the sectoral allocation policy, the amount allocated to the industrial sector amounted to $1,257.2 million (63.8 percent) finished goods $477.6 million (26.8 percent) and agriculture $45 million (2.5 percent) while in visible accounted for the balance. These disbursement were grossly inadequate for the economy. The number of officials foreign exchange market (FEM) bidding sessions dropped drastically from 43 in the preceeding year to only 15 in 1994 due to acute shortage of foreign exchange resources. The total amount of foreign exchange offered for sale by the CBN also fell significantly from $3103.9 million in 1993 to $1,880.0 million. However, the amount of foreign exchange released to the authorised dealers was $1.961.1 million in order to bridge the gap between supply and demand.

TABLE II

TRANSACTIONS ON THE FOREIGN EXCHANGE MARKET (FEM)

1990 - 1994

YEAR/MONTH	AMOUNT OFFERED (US & MILLION)	ACTUAL DEMAND BY BANKS (US & MILLION)	ACTUAL AMOUNT RELEASED TO BANKS (US & MILLION)	EFFECTIVE CENTRAL RATE	SELLING RATE (#)
1990					
TOTAL	2646.1	20196.6	2501.6	-	
AVERAGE	220.5	1683.1	208.5	80374	7421
1991					
TOTAL	3158.4	9452.3	2927.3	-	
AVERAGE	263.2	787.7	243.9	9.9331	8.
1992					
TOTAL	5080.4	6434.6	4045.7	-	
AVERAGE	423.4	536.3	337.1	17.376	9.9
1993					
TOTAL	3103.9	40641.9	2892.7	-	
AVERAGE	258.7	3386.4	241.1	22.161	
1994					
JANUARY	NIL	NIL	0.74	21.9960	
FEBRUARY	200	1161.5	0.7	21.9960	
MARCH	400	4879.4	439.2	21.9960	
APRIL	300	4513.7	310.4	21.9960	
MAY	200	4979	248.5	21.9960	
JUNE	100	2176	102.6	21.9960	
JULY	100	2638.7	192.6	21.9960	
AUGUST	100	2893.3	78	21.9960	
SEPTEMBER	120	2811	106.4	21.9960	
OCTOBER	120	3072.1	241.6	21.9960	
NOVEMBER	120	3222.2	119.5	21.9960	
DECEMBER	120	3344.5	120.8	21.9960	
TOTAL	**1880**	**35691.3**	**1961.1**		
AVERAGE	**156.7**	**2974.3**	**163.4**	**21.9960**	

As a result of this inadequacy and other problems stated above, the Government adopted the current policy. This policy is designed to maintain the current officials rate (US $1=#21.9960) and at the same time permit the Central Bank of Nigeria to intervene in the autonomous market. Essentially the new policy thrust is to ensure exchange rate stability in the management of the nation's resources. The policy recognises that this could be achieved through a comprehensive policy framework involving demand management supply side initiatives and complimentary measures. Fixing the exchange rate without the required complimentary measures and fiscal discipline would not achieve the desired result. In the light of the above the following measures were put in place in the 1995 budget to ensure the success of the policy of guided deregulation:-

1. The abolition of the 1962 Exchange Control Act.
2. The establishment of an autonomous foreign exchange market (AFEM) where the Central Bank of Nigeria would intervene in order to ensure reasonable stability in the market. Apart from that the CBN shall hold the official foreign exchange to meet priority Government obligations as well as strengthen the country's external reserves.

3. All companies, individuals or organisations shall source their foreign exchange requirements in the autonomous market.

4. The AFEM shall operate freely. However, for the avoidance of doubt no individual or organisation would be allowed to deal in foreign exchange except as provided in the relevant laws and regulations. Thus the parallel foreign exchange market remains illegal.

5. Bureaux de change shall buy foreign currency notes and coins and travellers cheques freely but shall sell only foreign notes and coins to a maximum of US $2,500.00 per transaction.

6. All Government parastatals government companies, agencies and companies in which Government has majority share holding, oil exploration and producing companies, recipients of foreign loans and grants shall continue to maintain their foreign currency domiciliary account with CBN the Banks shall purchase such funds at the prevailing autonomous rates and shall use these funds and other government foreign exchange to intervene in and influence the autonomous market.

7. The banks shall continue to maintain domiciliary account namely Non-oil export domiciliary account and ordinary domiciliary accounts for their customers to keep their non-oil export proceeds and other inflows.

8. All Government transactions with the CBN shall be at the official exchange rate. However commercialised companies shall source their funds in the AFEM.

9. All uncontainerised imports valued US $1000 and below are exempted from the requirement of preshipment inspection while containerised imports irrespective of value and source of funds shall continue to be subject to the pre-shipment inspection requirement.

10. Exporters are permitted to sell their export proceeds to authorised dealer banks at autonomous rate.

11. The importation and exportation of the naira remain prohibited. However, the amount which residents of Nigeria are allowed to hold on them for settlement of local expenses immediately on their return to Nigeria is increased from #500 to #1,000.00

In line with the new policy of foreign exchange management the Central Bank of Nigeria intervened for the first time in the autonomous foreign exchange market (AFEM) in February at the rate of #82.00 for one US dollar thereby moving the effective rate of exchange from #21.9960 to #82.00. This represent 272.79% depreciation of the national currency. Apart from that the banks were now expected to provide naira cover for foreign exchange allocated to them immediately. Hitherto the market has been a lucrative one for banks and that had contributed to the depreciation of the naira although other factors like the government's enduring deficit also had a role to play. Since there was, before now a high premium between the rate of the foreign exchange (forex) that passed through the banks and the value of the forex, the banks had not only bid for themselves in disguise, while the books said they were bidding for their clients, they had also imposed various charges on the forex actually bid for their clients. But with CBN selling at the street value rate, it became difficult to build up charges on the already exorbitant forex.

Since the banks were not expecting that CBN would sell at street value and also meet forex demands, their clients had not only inflated the forex wanted, the banks had also engaged in sharp practices. But with the present dispensation it has become difficult to tie down such large sums in a business that was no longer lucrative, hence the reluctance of eighteen (18) banks to pay for the forex bided at the first intervention in February.

The implications are that the banks would now be careful about what they ask for in future. And since their accounts are first debited, they have to dissuade their clients from inflating their foreign exchange demands. Of course, more banks will become insolvent and may have to close down while the amount of forex demanded will progressively reduce. Hopefully the naira will then appreciate the immediate consequence of the new forex policy is the the naira will depreciate as it has already done and prices of goods will go up. But if the CBN goes on withdrawing these billions of naira from the economy through selling forex at the strect value rate and goes on sqeezing the banks while the government keeps its own finances in order the CBN may at last be on the way to finding a lasting solution to the problematic foreign exchange market. From 21st February to 13th November, the Central Bank of Nigeria has intervened on five occassion selling \$405.3 million, \$268.0 million, \$383.0 million, \$200.00 and \$203.0 million foregn exchange resources respectively.

5-2-2 ACCESSIBILITY TO FOREIGN EXCHANGE IN 1995

FOREIGN EXCHANCE USERS	FROM OFFICIALS MARKET (AFEM)	PARALLEL MARKET
Individuals	50%	50%
Corporate bodies	80%	20%
source:Fild survey		

As shown in the table foreign exchange resources were more available to users in 1995 from official sources than in 1994. For instance individuals source 50% of their foreign exchange needs in 1995 from official sources as compared with 20% obtained from officals sources in 1994. Foreign exchange users admitted that foreign exchange resources and the naira exchange rate were more stable than in 1994.

5-2-3 DOCUMENTATION REQUIREMENT:

From the questionnaire administration I observed that many foreign exchange users complained about the documentation requirements they had to satisfy in the process of obtaining foreign exchange from official source (AFEM). They said it was too cumbersome. About 15% of those interviewed said they obtained their foreign exchange needs from the parallel market mainly because they were not required to complete documents.

5-2-4 SUPPLY OF FOREIGN EXCHANGE RESOURCES TO THE KANO ECONOMY

1/	Official (AFEM)	75%
2/	Domiciliary Account	6%
3/	Parallel Market	15%
4/	Others	4%

Source:field survey.

As shown in the table most of the foreign exchange requirements of the Kano economy were source from the autonomous market. This was followed by foreign exchange obtained from the parallel market where Lebanese were active participants many manufactures however complained about the high cost of obtaining their foreign exchange needs. For instance at N82 per US $1.00 the goods produced would be too expensive and that the warehouses were already bursting with unsold goods they argued.

CHAPTER SIX

SUMMARY, RECOMMENDATION AND CONCLUSION

6-1 Summary of the Findings

6-2 Appraisal of policy measures

6-3 Conclusion

6-4 Recommendation

This thesis examined foreign exchange management in Nigeria during the period preceeding SAP, the SAP period and post SAP period (fixed exchange rate policy in 1994 and the guided deregulation policy in 1995). Kano's economy was used as a case study.

6-1 SUMMARY OF THE FINDINGS

This study was designed to determine the management of foreign exchange resources since the enactment of the exchange control act of 1962. The art of foreign exchange management which is the main focus of this study is a conscious attempt to harness foreign exchange resources, deploy them to service the economy and to meet other international commitment while saving some to raise the level of international reserves. The study was based on both primary and secondary data. The primary data was collected through questionnaire administration and interviews. The questionnaire was administered on a randomly selected, 40 foreign exchange users (individuals and corporate bodies).

From the analysis of the responses and data collected during the survey, some findings were made on which some broad conclusions would be based. These findings include the following.

From 1962 1962 until June, 1986 the basic framework for foreign exchange management was the exchange control act of 1962 which was reinforced by the Economic stabilization (temporaryns) Act 1982. The 1962 act made provisions for measures to increase foregn exchange resources, reduce the disbursement of foregn exchange and preserve the nation's international reserves. Other policies that were adopted were either in pursuance of the objectives of the 1962 act or meant to reinforce the provisions of the act.

The major shortcoming of the exchange control system was its inability to achieve internal balance in the short-term and guarantee external equilibrium in the long-term. Over-valuation of the currency under the system was a major obstacle that made the achievement of internal balance difficult. There was an increased dependence on imports, deflation 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.

The pitfalls of exchange control led to its abandonment. Consequently a market based system commenced in July, 1986 with the structural adjustment programme (SAP). The SAP objectives include the achievement of balance of payments and fiscal viability, the rationalisation of public enterprises through privatisation and commercialisation the reduction in the level of unemployment and the attainment of sustained economic growth. To achieve the objectives of balance of payment and fiscal viability a market determined exchange rate mechanism was put in place, fiscal and monetary policies were tightened to be consistent with the achievement of balance of payment equilibrium.

In 1986 export licensing was abolished in order to boost exports. In addition commodity boards were scrapped so as to make exports of non-oil commodities more competitive. Also the foreign currency domiciliary account scheme became operational and exporters were now allowed to retain 100 percent of their export proceeds in their domiciliary account. To further boost non-oil exports, the Central Bank of Nigeria set up a Re-discounting and Refinancing Facility (RRF) in 1987. Nigeria's external reserves were further diversified in 1987 in order to maximise the nation's foreign exchange earnings.

To reinforce demand management policies in foreign exchange management new external borrowings as from 1988 were restricted to key projects. In that year a Debt conversion programme was introduced to further reduce the debt stock. In addition various debt rescheduling agreements were concluded with the London and Paris clubs of creditors.

To guide the foreign exchange market towards an appropriate exchange rate tight monetary and fiscal policies were embarked upon by the authorities. Thus in 1989, the Federal Government directed its ministries and parastatals to transfer their deposits from commercial and merchant banks to the Central Bank. Financial institutions were banned from granting loans on the basis of foreign guarantees. Loans already granted on that basis were recalled. The prescribed ceiling for credit expansion was reduced while cash reserve requirements, liquidity ratios and Central Bank's minimum were raised.

In 1990 the issuance of stabilization securities commenced in order to mop up excess liquidity from the system and thus reduce the effective demand for foreign exchange. Against the background of unsatisfactory economic performance and the clamour by many pressure groups including the organised private sector, the Government adopted the fixed exchange rate policy in the management of the nation's resources in 1994. The naira rate was fixed at #21.9960 to one US. Dollar. In the first five months of 1994, although the official naira rate remained at the pegged level of #21.9960 US. dollar, the parallel market rate diverged further, while the parallel market premium stood at about 125 percent at the end of May compared with about 100 percent as at the end of 1993. Market determined exchange rate was terminated at the end of 1993. Total foreign exchange receipts for fiscal 1994 were projected at US $8,131.0 million comprising officials receipts of $6,199.0 million and private sector earnings amounting to US $1,932.0 million. Disbursements were projected at $6,199.0 million with the balance earmarked for accretion to the country's external reserves. However, total receipt in the year showed a shortfall of $2009.8 million or 24.7 percent while disbursement were cut back by $1,468.6 million. Of the total official disbursement of $5,177.32 million debt service accounted for $1,694.9 million or 32.7 percent.

The main objective of the exchange rate policy adopted in 1994 (fixed exchange rate) were not fully achieved. Consequently the exchange rate policy was changed in 1995 to the guided deregulation policy. With the new policy (guided deregulation) every company, individual or organisation is to source its foreign exchange requirements in the autonomous market. The C.B.N will hold the official foreign excahnge and will intervene in the autonomous market in such a way that the gap between the official and parallel market will be narrowed.

6.2 APPRAISAL OF POLICY MEASURES

Before the introduction of the Structural Adjustment Programme, Exchange Control measures were applied to manage the nation's foreign exchange resources. The policy was intended to ensure among other things:-

1/ Improvement of the balance of payments position and the maintenance of a level of reserves consistent with external stability.

2/ Maximisation of foreign exchange receipts from all available sources.

3/ Enhancement of confidence in the external payment system in Nigeria by honouring International obligations subject to satisfactory documentation.

However despite the controls it was not possible to maintain a comfortable external reserves level over a long period of time. Infact the usefulness of exchange control as a balance of payments adjustment tool was limited. At best it suppressed the excess demand for foreign exchange but did not eliminate it as evidenced by the accummulation of trade arears in 1992.

Furthermore exchange control encouraged and promoted various malpractice to beat exchange control measures. Some of these malpractices include the following:-

i. Over-invoicing of imports to side track exchange restrictions and thereby transfer money illegally abroad.

ii. Refusal to surrender foreign exchange proceeds of exports by private exporters.

iii. Dealing in foreign exchange in the parallel or black market.

iv. Smuggling in various forms.

v. Corruption of officers suppose to administer and enforce the various control measures Policy measures applied under SAP were fashioned deliberately to eliminate price and output distortions in the economy, reduce foreign exchange leakages and excessive outflow of foreign exchange, eliminate the over valuation of the naira exchange rate in order to reduce the excessive demand for foreign exchange, increase domestic output and the supply of foreign exchange, stabilise foreign exchange transactions and guarantee external equilibrium without comprising the goal of domestic monetary stability. These policies were anchred on a flexible exchange rate mechanism propelled by market forces.

In real terms the introduction of Structural Adjustment Programme resulted in relatively more relaxed atmosphere for foreign exchange management. The success can be measured in various economic indicators . For instance, foreign exchange receipts which dropped from $12310.2 million in 1985 to $6976.5 million in 1986 rose to $9562.1 million in 1990. Reserves import ratio also improved from 2.9 months in 1985 to 9.5 months in 1990. During the same period, the balance ot trade which dropped from $5.7 billion in 1985 to $2.8 billion in 1987 rose to $9.0 billion in 1990. This was achieved as a result of the consistent improvement in exports which averaged $7.4 billion between 1987 and 1989 before climbing to $14.7 billion in 1990 and the relative stability in the value of imports during the review period after it was brought down drastically from the high level of the early 1980's. However, the operation of SAP brought about unintended adverse effects. The situation was worsened by Government's inability to control her expenditure patterns. The absence of monetary and fiscal discipline especially in 1993 led to macro economic instability. There was an increase in the rate of inflation and unemloyment. There was also low capacity utilisation, capital flight, malpractices and speculative activity in the foreign exchange market and persistent depreciation of the naira exchange rate. It was against these lapses that the government introduced the fixed exchange rate. The economy hardly recorded any growth during the year 1994. The broad objective of achievement of exchange rate stability was not realised. Economic performance that year was generally unsatisfactory despite government efforts to restore economic growth and price stability. The major reasons were foreign exchange constraints and protracted industrial unrest following the political disturbance that were witnessed in several cities in the federation.

In the real productive sector the aggregate index of agricultural production increased by 1.6 percent compared with 2.5 percent in the preceeding year. Similarly, the index of manufacturing production declined by 5.0 percent in contrast to an increase of 2.3 percent in 1993. As a result of the rate of capacity utilization stood at barely 30.5 percent compared with 36.7 percent in 1993. Inflationary pressure also intensified in 1994. the major causal factors were the adjustment in the price of petroleum products and the persistent depreciation of the naira exchange rate in the parallel market. Overall inflation rate stood at 70.0 vis-a-vis 57.2 percent during the corresponding period in 1993.

In the light of the above the fixed exchange rate policy was replaced by guided deregulation policy in 1995. This policy is mainly through the use of market forces even though there is provision for Central Bank to intervene to ensure exchange rate stability. Within the last eleven months the Central Bank has been able to reap a lot of naira by selling at high rate. For instance in the first intervention of February this year the Central Bank mopped up #33.2 billion from the economy when it sold $405.3 million at #82.00 per dollar. By doing so it reduced the excess money in circulation without recourse to stabilisation securities (debiting the excess funds of the banks) CBN intervention has also provided enough funds for the government to implement her programmes. In effect it has helped the government to balance its budget without a recourse to ways and means/printing money to cover the budget shortfall. However the rate at which Central Bank intervenes has been criticised by many interest groups especially the manufacturing association of Nigeria which feel it is too high. In an interview their spokesman said of the first intervention that at #82.00 the goods produced would be too expensive and that the warehouses were already burstling with unsold goods.

6-3 CONCLUSION

This study has examined foreign exchange management in the pre-SAP, SAP and the post-SAP era. Policy measures employed during this periods have been critically analysed.

In the Pre-SAP era, the 1962 Exchange Control Act was the basic frame work for foreign exchange management in the country. Within the SAP period (1986-1993) a market determined system replaced the rigid controls of the pre-SAP era. The objectives of SAP included the achievement of balance of payments and fiscal viability and sustained economic growth. The Post-SAP period have witnessed constant changes in exchange rate policies. In 1994 the government introduced the fixed exchange rate policy in the management of the nation's foreign exchange resources. In 1995 this policy (fixed exchange rate) was changed Guided Deregulation policy. The 1995 policy has brought about relative stability in the foreign exchange market. This implies that the future policy of foreign exchange management should be anchored on the 1995 policy with the necessary complementary monetary and fiscal policies as well as Government restraint and discipline in its resort to deficit financing. This forms the basis of any recommendations.

6-4 RECOMMENDATIONS:

1/

The Guided Deregulation Policy should continue to be used in the management of the nation's foreign exchange resources with some amendments. The current intervention by the Central Bank of Nigeria is quite infrequent and the time-lag between the actual intervention and the release of foreign exchange is too long. Intervention should be at least once every month and the release of foreign exchange should be immediate.

2/

Participation in the Autonomous Foreign Exchange Market (AFEM) should be widened to include oil companies. This would make it possible for the supply of more foreign exchange into the market and thereby significantly shore up the naira exchange rate.

3/

The prevailing state of macro economic instability should be properly addressed. For instance the 21 percent peg of interest rates in the face of an unprecedented devaluation of the naira and over 89 percent inflation as at the end of June has worsened the negative real rate of interest situation in the country. Interest rates should be deregulated so as to re align it with the current deregulated environment.

4/

The government should intensify efforts to increase the supply of foreign exchange into the economy. Current measures to stimulate non-oil exports should be vigorously pursued. In particular, the diversification of the non-oil export base should be intensified in order to reduce reliance on the oil sector and raise the level of non-oil receipts.

5/

Government agencies dealing with the promotion of the Nigeria's exports should be more aggressive in sourcing favourable markets for our exports. In addition the packaging and quality of Nigeria's exports should be enhanced to make them internationally competitive. In order to generate additional exports and ensure an overall conservation of foreign exchange resources, the level of domestic output should be raised. The increased production of both tradable and non-tradable commodities would reduce pressure on foreign exchange resources.

6/

Duties (excluding orders of ostentation/luxury goods) should be slashed by at least 50 percent to effectively address the problem of high cost of goods and boost capacity utilisation in the industrial sector.

7/

Monetary authorities should introduce commensurate punitive measures against banks involved in only speculative bidding in order to bring about professionalism and thereby shore up the value of the naira. In effect the current AFEM guidelines should be amended to make provisions for severe sanctions against banks specialising on only speculative bidding Banks should also be made to provide enough naira in their accounts to cover their foreign exchange demands within three days of the submission of their application forms.

8/

The issuance of stabilisation securities should be done more routinely to reduce the ability of banks to adjust their liquidity positions.

9/

The imposition of high tariffs on non-essential imports should be considered so as to further reduce the demand for foreign exchange. In addition debt service payments should be made less burdensome by negotiating a comprehensive multi-year rescheduling programmes for Nigeria's outstanding debts and pushing for debt reduction concessions like the ones already granted to Poland and Egypt by the Paris club of creditors.

10/

To permanently reduce the problem of foreign exchange scarcity local sourcing of raw materials should be encouraged and the capital goods industry should be developed so as to reduce the need for imports. This is informed by the data for foreign exchange allocation which indicated that disbursement to the industrial sector has been exceeding 50% since the introduction of SAP in 1986.

11/

Exchange rate should be allowed to float within a band. There should be a lower band and an upper band within which the CBN can intervene that is not less than the lower band and not more than the upper band. The divergence between the bands should not exceed 10 percent. the band of 10 percent was arrived at from the observed movement of the naira rate in the autonomous market since the first intervention by the Central Bank of Nigeria in February,

1995. To date the lowest rate of intervention has been #82.00 and the highest has been #85.00.

12/

The activities of Bureaux de change should continue to be adequately monitored. These include purchasing and selling privately sourced foreign exchange at the autonomous foreign exchange market (AFEM) at the prescribed autonomous rate. They should also be excluded from the channelling of CBN intervention funds to end users so that the major goals of deliberate building up and strengthening of external reserves to enhance confidence in the Nigerian economy could be achieved.

The policy on Domiciliary Account should be strengthened to encourage individuals to repatriate their foreign exchange resources abroad for use by the local economy. The Government should also scrap the official exchange rate so as to have a unified rate and thereby prevent possible abuse in the management of the nation's foreign exchange resources.

Finally, in the drive to earn more foreign exchange the Government should continue to support institutions such as the Nigeria Export Promotion Council (NEPC) and the Nigerian Export Import Bank (NEXIM)

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APPENDIX I

DEPARTMENT OF BUSINESS ADMINISTRATION, INSTITUTE OF ADMINISTRATION AHMADU BELLO UNIVERSITY, ZARIA.

FOREIGN EXCHANGE MANAGEMENT IN NIGERIA - CRITICAL APPRAISAL AND SUGGESTED POLICY MEASURE FOR THE FUTURE

BANKS QUESTIONNAIRE

1. Does your Bank have foreign operations department?

   a] yes b] no

2. What is your comment on Foreign Exchange Management between 1962 and 1985.

   a] Very Good

   b] Good

   c] Fair

   d} Poor

   e] Very Poor

3. What do you say about Foreign Exchange management between 1986 and 1993

   a] Very Good

   b] Good

   c] Fair

   d} Poor

   e] Very Poor

4. What do you say about Foreign Exchange Management in 1994

a] Very Good

b] Good

c] Fair

d] Poor

e] Very Poor

5. On the average were you able to satisfy the foreign exchange demand of your customer between 1970 and 1986.

a] yes b] No

6. If no brief give reasons for your inability to satisfy the demand.

....
....
....
....

7. On the average were you able to satisfy the foreign exchange demand of your customers between 1986 and 1993
a] yes b] No

8. If no briefly give reasons for your inability to satisfy the demand.

....
....
....
....

9. What is your comment on the structural adjustment programme introduced in 986.

a] It was appropriate and timely

b] It was not necessary

c] It should have been introduced earlier than that time

e] It was costly and the nation was not prepared at that time.

10. In your view what were the objectives of the Economic Stabilisation measures introduced in April, 1982.

....
....
....
....

11. Were these objectives achieved

a] yes b] No

12. What is your view are the merits and demerits of the import/licensing scheme of the 1970's and part of 1980's

a. merit ....
....
....
....

b. demerit ....
....
....

....

13. The general object of exchange rate policy has been to preserve the value of the reserves and maintain a stable naira. In your view which of these measures can best achieve an efficient exchange rate.

    a] Fixed exchange rate determined by the Government

    b] Flexible exchange rate determined by market forces

    c] Guided Deregulation

    d] Unfavourable Government policy against black market operators.

14. What is the structure of your bank credits to the external sector in the last three years.

PURPOSE OF LOAN	NUMBER	AMOUNT OF LOAN AND YEAR GRANTED 1994	1993	1992
a] Export of Goods				
b] Imports of Goods				

15. When assessing an applicant's ability to repay which sources of information do you usually use

    a/ Application form

    b/ Personal Interview

    c/ Previous records

    d/ Others specify

16. What are the acceptable collaterals for your banks loan.

....

....

....

....

17. How do you rate loan repayment by your borrowers

a] Very Good

b] Good

c] Fair

d} Poor

e] Very Poor

18. What is your comments on the March, 5 1992 devaluation of the naira.

....

....

....

....

19. In the 1994 Foreign exchange budget the Government re-introduced exchange control measures. Was this policy advisable or not.

a] advisable b] Not advisable

20. Give reasons for your choice.

....
....
....
....

21. What are some of the adverse effects of exchange controls.

....
....
....
....

22. What made the Government to reintroduced the guided deregulation policy as a means of managing foreign exchange resources in the 1995 budget.

....
....
....
....

23. Is your bank maintaining the domiciliary account for its customers

a/ Yes b/ No

24. As compared with foreign exchange obtained from officials sources what is the percentage of the quantum of credit from the domiciliary account.

a/ Very High

b/ High

c/ Low

d/ Very Low

25. To ensure stable exchange rate the supply side of foreign exchange should be increased what measures do you suggest.

....
....
....
....

26. What should be done to curb the incidence of capital flight

....
....
....
....

27. Do you agree that the problem of foreign exchange management is that of policy implementation but not formulation.

a/ Yes b/ No

28. If yes what implementation measures do you suggest.

....
....
....
....

29. What is the most efficient way of disbursing foreign exchange resources.

a/ Centralisation

b/ Decentralisation

c/ Combination of Centralisation and Decentralisation

30. Rank the sources of foreign exchange available to your bank the most important should score 5 and the least 1.

a/ Official sources (CBN)
b/ Bureau de change
c/ Parallel market

d/ Domiciliary account

e/ others specify.

APPENDIX II

DEPARTMENT OF BUSINESS ADMINISTRATION
INSTITUTE OF ADMINISTRATION
AHMADU BELLO UNIVERSITY,
Z A R I A.

<u>Foreign Exchange Users Questionnaire</u>

Individual **Corporate Body**

1. Type of Company

a. Manufacturing

b. Trading

c. Agricultural

d. Tertiary/service

2. When did you start using foreign exchange.

   a. Since 1950

   b. Since 1960

   c. Since 1970

   d. Since 1980

e. Since 1990

3. What is the major source of your foreign exchange purchase

   a. Through banks

   b. Parallel market

   c. Bureau de change

   d. Domiciliary Account

4. Do you maintain domiciliary account

   a] Yes b] No

5. If yes which bank?

   ....

6. How do you or your company generate foreign exchange?

   ....
   ....
   ....
   ....

7. What are the uses to which you put the foreign exchange you usually purchase.

   ....
   ....
   ....

....

8. Do you enjoy credit from banks

a] Yes b] No

9. For the past two years, how much have you borrowed from banks

a] #.0 ---------------- #10,000.00

b] #10,001-------------- #100,000.00

c] #100,001 ------------ #1,000,000.00

d] #1,000,001 ---------- #10,000,000.00

e] Above #10,000,000.00

10. Have you noticed any difference between the use of credit in production and the lack of it?

a] Yes b] No

11. If yes what is the nature of the difference?

a] Improvement in productivity

b] Decrease in Productivity

c] Others (specify) ....

....

12. What percentage of the current foreign exchange earnings should be allocated to the following sectors of the economy.

a/ Manufacturing --------------------------%

b/ Agriculture -----------------------------%

c/ Other Imports ---------------------------%

13. What is the current percentage of capacity utilisation of your company

a] 0 ---------------------- 20%

b] 21%------------------- 50%

c] 51%------------------- 75%

d] Above 75%

14. What is the percentage of imported raw materials component in your production of goods and services?

a] 0 -------------------------- 25%

b] 26% ---------------------- 50%

c] 51% ---------------------- 75%

d] 76% ---------------------- 100%

15. What efforts are you making to source your raw materials locally.

a/ Very strenuous

b/ Strenuous

16. Under which of these policies did you easily obtain foreign exchange?

a/ Exchange Control Regulation 1962/1985

b/ S.F.E.M.

c/ F.E.M.

d/ Exchange Control Regulation 1994

e/ Guided Deregulation 1995

17. How often do you request for foreign exchange in a year?

a/ Once

b/ Twice

c/ Thrice

d/ more than thrice

18. How is your performance in terms of your credibility rated by your suppliers or creditors.

a. Very High

b. High

c. Low

d. Very Low

19. What problems do you encounter in the purchase of foreign exchange from officials sources?

d. Very Low

19. What problems do you encounter in the purchase of foreign exchange from officials sources?

....
....
....
....

20. What problems do you encounter in the purchase of foreign exchange from so called parallel market?

....
....
....
....

21. Are you satisfied with the current policies towards the so called parallel market?

a/ Yes b/ No

22. If No what do you suggest?

....
....
....
....

23. What practical measures should the Government take to increase foreign exchange inflow?

....
....
....
....

24. In the past five years what has been the total purchases of foreign exchange from all sources?

a. 1994 ------------------------#

b. 1993 ------------------------#

c. 1992 ------------------------#

d. 1991 ------------------------#

e. 1990 ------------------------#

25. In your opinion what can be done to reduce the incidence of foreign exchange malpractices?

....
....
....
....

26. What can be done to encourage export promotion?

....
....