TITLE PAGE

BANK LIQUIDITY AND THE DEREGULATED FOREIGN EXCHANGE RATE IN NIGERIA

PRESENTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION OF THE AHMADU BELLO UNIVERSITY ZARIA.

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DECLARATION

I hereby declare that this project entitled 'Bank Liquidity and the Deregulated Foreign Exchange Rate' is the result of my personal initiative and the findings are the product of my research.

To the best of my knowledge, it has neither been previously presented nor accepted as any submission for a higher degree.

All data used and works consulted have been duly acknowledged in the footnotes and references.

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CERTIFICATION

This project entitled "Bank Liquidity and the Deregulated Foreign Rate" by Mr. Robert Kemepade Moruku meets the regulations governing the award of the Degree of Masters in Business Administration (MBA) of the Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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HEAD OF DEPARTMENT	23/11/98 DATE
DEAN, POST GRADUATE SCHOOL.	24/12/99 DATE

DEDICATION

This research project is dedicated to my family.

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ABSTRACT

Deregulation of the naira exchange rate and the supplementary monetary policy regime were aimed at reducing the demand for foreign exchange and boosting non-oil exports. (CBN, 1992: No. 92/08; Abdullahi, 1987:59; FGN, 1988:21-23).

An 'excess liquidity' in the banking system was said to be an obstacle to achieving the aims of the foreign exchange and monetary policies. (CBN, 1990: 32; Ntekop, 1992:21) Stabilization Securities were repeatedly issued on bank deposits to mop up the 'excess liquidity'. But this left in its wake high cost of funds, inflationary pressure, distress in the banking system, industry capacity under utilization, volatile exchange rate regime, and persistent demand pressure on the foreign exchange market. (Business Times, April 12, 1993; CBN Circ. 1/3/93; Nwankwo, 1983:44; Abdullahi, 1987: 63-65; Ahmed, 1993:23; CBN, 1991:66; Olekah, 1991).

Thus this study was initiated to determine the cause - effect relationship between the liquidity in the banking system and the deregulated foreign exchange rate through the demand pressure on the foreign exchange market.

A quasi-experimental design was developed and multiple regression and Pearsons (r) analyses were conducted on the data. The result of the analysis shows that there is no significant relationship between them. The demand pressure is inherent in the market itself and reflects the structural problems of the economy which are monocultrual and vulnerability to external shocks; of industry that is import-dependent, and import-substi-tutional.

We suggest a systematic reduction in the demand for foreign exchange through a reduction for the need for foreign exchange by the determined sourcing of local inputs since the demand for foreign exchange is a derived demand for imported inputs. We also recommend an interim dual exchange rate system to be replaced in the long-run with a floating, market-determined exchange rate system.

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"... I mean in choosing, greater lengths and avoiding smaller, where would lie salvation? In the art of measurement or in the impression made by appearances? Haven't we seen that the appearance leads us astray and throws us into confusion so that in our actions and our choices between great and small we are constantly accepting and rejecting the same things..."

- Plato.

"The optimum condition for any country to enjoy is that in which prices are steady at a high level of employment and the balance of payments is in long-and-short-run equilibrium. If heaven is divided into nation states that is how it will be. On earth just now it is different."

- W.M. Scammell.

CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND/OVERVIEW

Deregulation of the foreign exchange market was one of the main policy instruments for the implementation of the Structural Adjustment Programme (SAP) introduced by the Federal Government of Nigeria in September, 1986.

It was designed to achieve a reduction in the demand for imported goods through the reliance on relative prices of imported and locally produced goods, and in this way relieve the pressure on the external balance of payments. It was also expected to discourage import - oriented assembly-type industries that make a heavy demand on the foreign exchange resoures of the country. Another objective was to promote agricultural production. Finally, It was aimed at promoting non-oil exports.

The deregulated foreign exchange market was expected to achieve all these objectives through the price mechanism believed to be an efficient allocator of scarce resources, and determinant of the 'appropriate and realistic' rate of exchange of the naira for foreign currencies. If the deregulation of the foreign exchange market could achieve all these, it may well be that an industrial revolution for Nigeria would be expected. The role assigned to the foreign exchange market is based on the faith of the monetary authorities that the foreign exchange rate has a strong relationship with macroeconomic variables such as inflation, money supply, and price levels between locally produced goods and imported ones and therefore can be manipulated to achieve the objectives of the Structural Adjustment Programme.

This was why the monetary authorities adopted tight monetary policies to control domestic money supply. Some of these policies were the setting of high cash and liquidity ratios, freezing of advance deposits in banks against letters of credit, and issuance of stabilization securities to mop up what has been perceived to be an 'excess liquidity' in the banking system.

Other measures of restrictive money supply were withdrawall of public sector deposits from banks, abolition of foreign guarantees of currency deposits as collaterals for naira loans.

Banks have been the target of these policies because of the belief that they are pivotal to the mobilization and financialization of savings in the savings - investment process. Their deposits are traditionally viewed to constitute the major proportion of a nation's money supply and by their credit creation, inject high - powered money into the economy.

These policy measures have been implemented for eight years. This lapse of time should be sufficient for one to appraise the results of the policy implementation.

Our main interest is to examine the relevance of the management of liquidity in the banking system by the monetary authorities to the foreign exchange crisis in Nigeria. They believe that excess liquidity exists in the banking system and therefore issued stabilization securities to mop it off. However, banks disagree that excess liquidity exists, and challenge the monetary authorities to prove it. They report that the issuance of stabilization securities on their deposits has placed them on a very tight and precarious liquidity position, compelling them to borrow at very high interest rates to be able to meet depositors' transactions demand.

This has resulted in a crash in the interbank lending rate and a train of side effects on the economy. It has been reported that banks' lending rate to the public has been so high that access to credit has become difficult for the real sector of the economy. This rate is said to determine the cost of production, price of goods and services produced, and agregate demand. Thus industry reels in dwindling sales in volumetric terms, buildup of unplanned stock of finished goods, and declining working capital resources resulting from credit contraction, inflation and inventory growth. There is also the widely believed declining capacity utilization, high and increasing cost of debt servicing and repayment default on borrowed funds, leaving large non-performing credits in the banks' investment portfolios.

At the same time labour demand for wage increases has often resulted in work-to-rule outright strike and vandalizing of equipment, machinery and buildings worth millions of naira. Lost man hours and production have cost industry large incomes.

The deregulated foreign exchange market is not without its problems. It appears that the demand pressure on the market has not relented, the exchange rate, volatile; and the external value of the naira hardly appreciates. The monetary authorities appear to be treating the symptoms rather than the causes of the foreign exchange crisis in Nigeria. The causes of the demand pressure on the official foreign exchange market should be accurately diagnosed to enable the monetary authorities apply the relevant treatment.

The demand for foreign exchange is a derived demand for foreign goods and services. For demand management policies to be effective, the demand for foreign goods should be elastic and the elasticity should exceed unity. A self-sufficient but not necessarily autarkic economic base appears to be required to achieve this. Unfortunately, ours is a totally import-dependent economy.

It looks as if we are drawn into a global exchange relationship of the sort we are ill-equiped for. Surplus local production and underconsuption should logically and naturally lead to an export drive. Appropriate policies in these areas ought to be worked out as current policies seem to be less than desirable.

1.1 Statement of the Problem

Excess liquidity is believed to exist in the banking system, exerting demand pressure on the foreign exchange market. Consequently the monetary authorities adopted tight monetary measures to reduce the level of liquidity in the system, and relieve the pressure on the official foreign exchange market.

Banks on the other hand are said to be reeling in illiquidity following the forced issuance of stabilization securities on their deposits. Eighteen banks have been reported distressed, five of them published and their managements taken over by the Central Bank of Nigeria - appointed Interim Management Board (IMB). These banks are experiencing deposit runs despite assurances given to the public by the monetary authorities about the safety of their deposits.

The policy measures adopted to manage the liquidity in the banking system, foreign exchange and industrial crises have generated macro-economic instability and erosion of confidence in the banking system.

To look into the problems, we raise the following leading questions to highlight the issues involved:

Does bank liquidity predict demand pressure on the foreign exchange market?

In an import - dependent, open economy, can qualitative restrictions such as curtailment of foreign exchange supply dampen the demand for imported goods if the price elasticity of demand is low?

Is the Nigerian official foreign exchange market being adequately managed by the price mechanism?

Are the policy measures adopted by the monetary authories relevant to the development of the economy and are capable of turning it around?

How much confidence do we have in the naira and the economy?

1.2 Objectives of the Study

The objectives of the study are:

1. *To determine the relationship between liquidity in the banking* system and demand for foreign exchange in the official foreign exchange market.
2. To find out the factors responsible for the demand pressure on the official foreign exchange market and make policy recommendations for managing them.
3. *To identify the causes of the persistent depreciation of the naira* and recommend policy measures to arrest the continuous slide in the value of the naira.

1.3 Significance of the Study

The findings of this study will

1. be useful to policy makers in government and the Central Bank of Nigeria as input in future policy formulations.
2. be of interest to academicians in international finance and development economics as it dwells on current and topical issuess in *these fields of study.*
3. interest bankers who are directly affected by the liquidity and foreign exchange crises. *The findings will be particularly useful* in bank liquidity management.

4. benefit the general public who are the beneficiaries of policy ends.

5. inform the inquiring minds for an increased uderstanding of financial issues for the sake of it and for making informed decisions.

6. provide treasury managers and/or investment analysts in business with useful insights into liquidity management in a deregulated market situation and tight monetary policy environment.

7. Provide a basis for assessing the advisability of the policies adopted for managing the foreign exchange market and liquidity in the banking system.

8. increase the author's understanding of the operation of the Structural Adjustment Programme and the deregulated foreign exchange market.

1.4 Scope of the Study

The study will embrace the demand for and supply of foreign exchange in the official foreign exchange market in Nigeria.

The demand will be the aggregated foreign exchange required by the authorized dealers (buyers).

The supply will be the total foreign exchange made available at the official foreign exchange market by the Central Bank of Nigeria.

All authorized dealers, commercial and merchant banks are going to be studied.

We will also study the liquidity in the banking system in relation to the demand for foreign exchange in the official foreign exchange market.

1.5 Limitation of the Study

The study is subjected to a number of limitations:-

1. Lack of complete knowledge about fundamental theoretical relationships

among variables and complete data restrict the analysis to those variables strongly suspected to influence the behaviour of the foreign exchange market. The data on the demand for foreign exchange is less than accurate.

2. A control group cannot be designed for the purpose of isolating the impact of change in one variable on the others. The changes are simultaneous for all the independent/predictive variables.

3. The Nigerian economy is influenced by many internal and external forces. Therefore, it will be difficult to isolate the effectiveness of domestic policies on the foreign exchange market.

4. The structure of the foreign exchange market in Nigeria is monopolistic with the Central Bank of Nigeria (CBN) being the only supplier of foreign exchange in the official market, Thus the operation of the market may be distorted. This will distort the relationship among the variables being studied.

5. A wholesale generalization of the findings of this study on Nigeria to other countries may not be possible because of the different characteristics and levels of development of the economies. In other words, no general theory on foreign exchange may be produced from this study to help explain observations in other countries despite the best efforts of the author, and the advantages to be derived from a general theory of foreign exchange.

1.6 Delimitation of the Study

It is not possible within the limits imposed by available resources to study the entire subject matter of foreign exchange and liquidity management. Thus for the purpose of this study, we delimit the coverage to:

1. The official foreign exchange market, leaving out the bureaux de change and the black markets as the volume of transactions in them

may not be easily ascertained to a fairly acceptable degree.

2. A study of the commmercial and merchant banks allowed to take retail and wholesale deposits under the relevant banking laws. It is the mobilization and financialisation of these deposits that constitute the money supply to the economy and increase the liquidity in the system.

3. The period 1986 to 1991; that is, a period of 12 years is studied.

1.7 Methodology

1.7.1 Research Design:

The design considered appropriate to this research based on the method of analysis of data is the quasi - experimental research design.

This design highlights the relationship between the dependent and independent variables and the effect of changes in the independent variables on the dependent variable.

For this purpose, the one group pretest - postest design has been used:-

$$E : Y_1 \; X_1 \; Y_2$$

where

E = non-randomized experimental group

Y_1 = demand for foreign exchange in the past year

X_1 = treatments administered in the year

Y_2 = the demand for foreign exchange in the year

Because of the nature of the subject, it is not possible to obtain a control group as the economy cannont be so demarcated.

1.7.2 Method of Data Analysis

The Pearsons[r] correlation analysis will be used to analyze the data.

This statistic is relevant for establishing the numerical level of relationship between the dependent variable and each of the independent variables as well as the interaction among the independent variables.

We will also use the multiple regression analysis to determine the quantity of change in the dependent variable when the independent variables change by a certain quantity. This statistic is important for predictive purposes. By extrapolation of the independent variable in the regression equation, the level of dependent variable can be obtained.

Then we will use the time-series graphical analysis to show the relationship between the dependent and independent variables and the quantity of change in the dependent variable arising from a change in the independent variable.

1.7.3 Sources of Data

Data will be obtained from secondary sources. These were data collected rugularly by the Federal office of Statistics and the Research Department of the Central Bank of Nigeria and published in the authoritative journals of economic and financial review of the Central Bank of Nigeria.

Data on the liquidity position in the banking system originate from the banks in the mandatory mid-month statistics rendered to the Central Bank of Nigeria. It is thus most economical and conviniently obtained from the consolidated report of the Central Bank.

The data are of a very high quality, reliable, and complete. Because of the sensitive nature of the data on bank liquidity, an attempt to generate them by questionnaire from the individual banks will not be successful. The attempt may be viewed as a means of exposing the illiquidity or fiancial distress of the banks. Besides, the use of questionnaire will make it impossible to study the total banking system.

The use of the high quality secondary data will enable us to study the total commercial and merchant banking population at a very low cost without sacrificing the quality of the results.

1.7.4 Method of Presentation of Results:

Results of the analysis of data will be presented in tables and time-series graphs.

The tables are useful in summarizing the results of the analysis of the data and help the reader see the predicted relationships at a glance.

Graphs presented as smooth curves will be especially useful in showing peaks and troughs highlighting the effects of monetary policies on the variables being studied. They will further show how the variables relate to one another over the study period and whether the dependent variable responds to changes in the independent variables.

1.8 Research Hypotheses

Based on the general review and research questions raised, the following hypotheses are advanced.

Hypothesis One:

There is no relationship between the demand for foreign exchange and its supply.

Hypothesis Two:

There is no relationship between the demand for foreign exchange and imports into Nigeria.

Hypothesis Three:

There is no relationship between the demand for foreign exchange and the liquidity in the banking system.

Hypothesis Four:

There is no relationship between the demand for foreign exchange and private capital outflow.

1.9 Definition of Terms

Some of the words used in the context of this study are technical and may not be easily understood by the general reader. To facilitate the appreciation of the study by the various publics these terms are defined:-

Authorized Dealers:- are commercial and merchant banks authorized by the Central Bank of Nigeria to buy and sell foreign currencies in the official foreign exchange market.

Deregulation (foreign exchange market) refers to a shift from administrative controls to a market-based control and allocation of foreign exchange.

Foreign Exchange refers to the currency of a country other than ones own country. Major foreign currencies include United States dollar, British pounds sterling, Japanese yen, Italian lira, German deutchmark and CFA franc.

Foreign Exchange Market means the market for buying and selling foreign currencies.

Foreign Exchange Rate is the price of one currency in terms of another, or how much of one currency required to exchange for one unit of another currency.

Interbank Market is the money market in which banks buy short-tenored funds usually for overnigh funding of their clearing account with the Central Bank of Nigeria.

Interbank Rate: is the rate of interest at which one bank lends funds to another in the interbank (money) market. This rate determines the rate at which banks lend to the public since the deregulation of interest rate by the monetary authorities.

Non-oil exports: comprise chiefly of exports of agricultural produce and manufactured goods.

Price mechanism: refers to the interplay of the forces of demand and supply in determining the equilibrium price/exchange rate and allocating of foreign exchange among competing buyers and suppliers/sellers in the foreign exchange market.

Productive/Real Sector: comprises of agriculture and industry.

Stabilization Securities: are non-marketable, low interest-yielding instruments issued by the Central Bank of Nigeria to commercial and merchant banks to mop up liquidity from the banking system aimed at stabilizing the money supply to the economy.

Structural Adjustment Programme: is a policy programme of restructuring of the economy emphasizing production for export, less dependence on imports and oil as a foreign exchange earner.

Liquidity: means maintaining adequate funds to meet all obligations or commitments at all times at normal market rates of interest.

Liquidity Management: is the management of funds which is aimed at maintaining a balance of productivity, solvency, and liquidity.

CHAPTER TWO

REVIEW OF THE LITERATURE

2.1 Fixed Exchange Rate in Nigeria

The begining of exchange control as a regulatory tool was in 1950 when the Exchange Control Ordinance of December 1950 was enacted. (Ahmed, 1985: 7-8).

The Exchange Control Act of 1962 passed by Parliament provides the main framework for the administrative control of the foreign exchange rate of the Nigerian pound. It was reinforced with the Economic Stabilization (Temporary Provisions) Act of 1982. (Obaseki, 1991: 61). These provided among other things the exchange rate administration and control.

The value of the Nigerian pound up to when it was changed to the naira in 1970 and the naira thereafter was pegged to the British pound sterling and the rate of exchange was fixed. For example, from 1960 to 1973, the Nigerian currency was pegged to the British pound sterling in the ratio of 1:1 until the former was devalued by 10 percent and allowed to float independently of the pound sterling. Thereafter the naira was appreciated to facilitate the sourcing of imports cheaply to finance development projects (CBN, 1992:3).

The adoption of the fixed and stable exchange rate was informed by the prevailing philosophy of foriegn exchange management at the time: WICKHAM (cited in ABDULLAHI, 1987) found from a survey of the choice of exchange rate regimes in developing countries of a wide practice of the maintenance of a fixed exchange rate by these countries. He supported the maintenance of a fixed link to an external standard for developing economies as it provided a stable framework within which to organize consistent monetary,

fiscal, and demand management policies.

The maintenance of a fixed relationship also enabled developing countries to determine the appropriate exchange rate with the key currencies of the world and derive value for their currencies through the respective crossrates. (Pelegan, 19). He believes that this had to be so because theye are non-trading currencies and their value cannot be determined on the basis of foreign exchange dealings.

The practice of fixed exchange rate regime originated from the Bretton Woods agreement in 1944. At the Bretton Woods conference held under the auspices of the United States of America, forty-four (44) nations of the world agreed to set up the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) or World Bank for short. The IMF required its member-nations to peg their currencies to the American Dollar or to the gold (Toffler, 1981: 104). It hoped to secure the advantages of the gold standard without its disadvantages. It put in place exchange rate stability and fixity. The rate was to be changed only when it was proved that their balance of payments were in a fundamental disequilibrium,(Samuelson, 1976:711: Killick, 1981:207).

Pure fixed exchange rate system was found in the gold standard. The gold standard theorists believed as others that the international monetary system was held by a series of equilibrium rates of exchange that must not be upset, and that this rate hopefully, was pegged by the mint parity (Scammell, 1975:71).

However, the fixed exchange rate system was not to hold forever, as developments in the international monetary system brought pressure to bear on the existing exchange rate regime.

2.2 Floating Exchange Rate System

Since 1973, a world wide regime of floating exchange rates has emerged. This had been iminent since 1960 as the international monetary system has been in crisis. It exploded in August, 1971 when the United States unilaterally suspended the convertibility of the dollar into gold.

The failure of the U.S. dollar and British pound sterling to serve as anchorsheet for the Bretton Woods system and as reserve and trading currencies led to the breakdown of the fixed exchange rate system. In particular, the disproportionate expansion in the supply of the dollar and sterling undermined their purchasing power and confidence in them. This unleashed a crippling inflationary impact on the world economy. Both deficit and surplus countries then pursued national policies that undermined and contradicted the Bretton Woods system of fixed exchange rate. (Felagan, 19 : 124)

Thus the exchange rates of the major currencies are floating. Betweem 1967 and 1973, four (4) major currency changes took place that were of fundamental and far-reaching effect on virtually all currencies of the world. Thus the International Monetary Fund was compelled to amend its Articles of Agreement to accomodate the new practices. And when the exchange rate of key currencies vary in relation to one another, many developing countires have no choice but to peg their currencies to one of the major trading currencies and to allow its value to float with it. Such fluctuating rates introduce instability into the price and volume of exports of developing countries. (Felegan 19 :33 & 34: Killick, 1981:207 - 208).

It is against this background that Nigeria's deregulated foreign exchange rate system is examined.

2.2.1 Exchange Rate Deregulation in Nigeria

The deregulation of exchange rate in Nigeria was introduced on the the adoption of the Structural Adjustment Programme (SAP) in September, 1986.

The shift from administrative control to a free market system in the determination of the exchange rate was intended to correct what was claimed to be an overvalued naira in order for it to find its appropriate value. (Abalu and Ingawa, 1987 : 143&144). According to them the naira exchange rate was overvalued and well above the equilibrium rate which is the rate determined by the interaction between supply of and demand for foreign exchange. They believe that an overvalued currency is unhealthy for a country's economy because all things being equal, it often leads to a chronic balance of payments deficit.

The policy was one of the instruments to implement the structural adjustment programme. It was assigned the role of reducing the demand for foreign exchange through the reliance on relative prices, of reducing the dependence on imported goods; encouraging the use and consumption of local resources and of increasing agricultural productivity through the enhancement of prices of agricultural produce.

According to the Central Bank of Nigeria (1992 : No. 92/08) it was inevitable to have recourse to the market place to determine the exchange rate to stop capital flight, round-tripping, and various abuses of our foreign exchange resources which were possible with the administrative control system. It also gave foreign exchange crisis in 1982 following the oil glut of 1981 as another reason for the adoption of a deregulated exchange rate system. That crisis

was reported to have led to an accumulated payment arrears on current transactions that could not be settled as a result of the decline in foreign exchange earnings. There was panic in the entire system: Letters of credit already confirmed were revoked since many countries refused to extend further credit to Nigeria.

Abdullahi (1987:59) believes that overvaluation of the naira means that the real exchange rate (real worth) of the naira was much less than its nominal value relative to the currencies of Nigeria's trading partners. This gave the naira an artificially high purchasing power. Thus it encouraged import orientation as relative price of imports were cheaper than local goods.

Was it an appropriate policy instrument to resolve the foreign exchange crisis and the other enconomic problems it was assigned to?

As Longe (1993) querries, if an overvalued currency is that injurious to a country's economy, why do other advanced countries call on Japan to raise the value of her currency (the Yen) as it is alleged to be undervalued.

Krein (cited in Ndebbio, 1987:101) associates exchange rate deregulation with a classical control mechanism usually employed by industrialised countries of Western Europe, North America, and Japan to control imports and stimulate exports. Thus he believes that Nigeria, and indeed, a third world country with a weak industrial base to be able to apply successfully this control mechanism, it must overcome all the limitations of import substitution industrialization as well as set a good industrial environment in terms of provision of necessary infrastructure.

Attah, et al (1987:7) faulted the exchange rate policy on its narrowness which was aimed primarily at correcting balance of payment disequilibrium rather than being fixed to a broad based, comprehensive development objectives. They cite socialist economies where over-or under-valuation of domestic currencies become a deliberate policy strategy to achieve industrial development. This

argument condenses to the point that contary to the bad scenario painted over-valued naira, there is nothing inherently bad about overvaluation, as it may be resolved rationally to achieve development objectives, namely to source capital goods to build the industrial base of the country.

They are sceptical about the ability of the market mechanism to determine the appropriate and realistic exchange rate, as the arrangement can and did easily influence in an indirect manner a contrived exchange rate by simply controlling the supply of foreign exchange over which the Central Bank of Nigeria excercises a monopoly power. Another weakness they spotlighted was that market forces may favour the allocation of foreign exchange resources to consumer goods to the detriment of capital goods due to the timing of the profitability of consumer goods.

Central Bank of Nigeria 1990 fourth quarter report (1990:31) showed that the relative shares of foreign exchange allocation to raw materials, machinery and spare parts sub-sectors remained stable with marginal increases. But allocations to finished goods sector went up by 50.3 percent to U.S. $260.1 million with a share of 77.1 percent of total allocations.

The workability of the foreign exchange market was undermined by the existence and operation of the parallel (black) market which received the official blessing of the monetary authorities. The yawning premium between the rates of the official and parallel markets stoked pressure on the former, as it led to round-tripping. (CBN, No. 92/08:3 and 4) It was a pratice by which (some) authorized dealers charged premium on foreign exchange purchased from the offical market which they sold to their customers. It was in an attempt to wipe out this premium that the monetary authorities further depreciated the naira from ₦10.110 to the dollar to about ₦18.7860 to the U.S $1.00 in 1992.

Yet the monetary authorities claimed that the exchange rate was determined by the price mechanism on the basis of the interaction of demand for and supply of

foreign exchange in the foreign exchange market. It now appears that it was the black market and the monetary authorities that arbitrarily determined the exchange rate. Such a rate can hardly be called "appropriate" and "realistic" which confirmed the fears of Attah, et al (1987:6).

Structurally, the foreign exchange market was and still is monopolistic with the Central Bank of Nigeria as the sole supplier of foreign exchange in the official market. Thus, true to economic theory of the market, the Central Bank of Nigeria was the price setter by controlling the quantity supplied at each bidding session. The demand was and still is in excess of the supply of foreign exchange. Banks were compelled by the inadequate supply to bid excessively high, and even transferred the demand pressure to the parallel market. (Business Times, April 12, 1993)

This structural deformity was the fundamental weakness in the foreign exchange market/deregulation. The price was determined according to the whims, caprices and prejudices of the Central Bank of Nigeria. This in turn stoked exchange rate volatility which was observed in the entire market, precipitating a regime of panic, uncertainty, instability, and planning crisis.

It has been acknowledged (CBN Cir. March 1, 1993) that the exchange rate policy failed to staunch capital flight, and even really encouraged it. This was the reason for the suspension of the bills of collection and open accounts as a means of handling imports. Business Times (April 12, 1993) reported that in a bid to circumvent the new rule by the Central Bank which required upfront payment for goods imported, big time importers resorted to bureaux de change for import transactions. This alliance together with the perenial undersupply of foreign exchange at the official market was believed to be responsible for the dwindling value of the naira against other world currencies before the reversion to the current fixed exchange rate regime.

The policy of exchange rate deregulation was unarguably a failure as an instrument for determining an appropriate and realistic exchange rate for the naira via the price mechanism. Was it successful in the more specific areas of curtailing imports and resuscitating the productive sectors?

2.2.3 Exchange Rate Deregulation and Reduction of Imports:

One objective of the exchange rate deregulation was to reduce the consumption of imported goods and encourage the use and consumption of local resources.

The exchange rate policy did not halt the importation of finished consumer goods *because of the inelasticity of the demand for them. The Marshall-*Lerner condition of elasticities analysis of exchange rate flexibility *specifies that the sum of price elasticities of demand for imports and* exports must be greater than unity for an exchange rate change to curb the importation of goods and improve the external balance. Preliminary estimates of these for Nigeria have been small and statistically insignificant. (Osagie, 19-147 & 148; Killick, 1981:206;Ojowu, 1987:17).

Import dependence would not be altered because local production did not meet up with demand. Shortages of imported goods created a market for smuggled goods (Abubakar, 1987:248). In fact the oil boom and the illusion of wealth it created had grown a bourgeoise-aspirant urban dwellers with a high degree of spending power and an insatiable demand for the good things of life which Adlai Stephenson (cited in Shanks, 1973:16) called the 'revolution of the rising expectation' in Nigeria. Nwankwo (1983:44) called it expectation transformation.

The glaring contradiction in the exchange rate policy and the import-reduction objective could only perpetuate the import-dependent syndrome: Import reduction policy was executed in a free market climate marked by trade liberalization. With trade liberalization almost anything was imported subject only to availability of foreign exchange. In any case

foreign exchange was obtained in the black market at any cost.

Relative price differentials were not sufficient to reduce importation of goods. Central Bank of Nigeria (circular 1993) on the suspension of bills of collection and open accounts acknowledged the persistent pressure on the official foreign exchange market. Customers gave open cover notes to banks in respect of the quantity of foreign exchange as well as the rates at which they were prepared to buy them. (Business Times, April 12, 1993)

Another difficulty encountered in import reduction efforts was with the nature of goods imported. Consumer goods that were not produced in the country had to be imported. Attempts to block them from being imported through qualitative means only create boom for smuggling activities. Consumers were prepared to buy at whatever price.

Even those produced locally in many cases were in short supply as industries were producing below capacity for insufficient foreign exchange to import raw materials and usually of lower quality. Infact lack of raw materials, foreign exchange inaccessibility, or prohibitive cost of foreign exchange translated to higher local cost of production/prices (Abdullahi, 1987:63-65). This created a boom in the importation of fairly used cars, refrigerators, television sets and other domestic electrical goods. This was dumping in effect. These goods were even cheaper than the locally made items.

2.3 Exchange Rate Deregulation and Non-Oil Export

An increase in non-oil exports vis-a-vis a reduction in imports seem to derive from the logic of income-absorption approach to foreign exchange and balance-of-payments management. Alexander (cited in Osaigie, 19- :147-148) posits that for this to work, national income (from exports) must be larger than the increase in absorption (from import consumption). However rapid population growth, increasingly vociferous trade unions and the demonstration effect

encouraged by the spread of mass media conspire against achieving this objective.

Wagner's formulation (cited in Longe, 1984) that the ratio of government expenditure to gross national product should expand as economic growth proceeds highlight s the increasing absorption posited by Alexander. The finding in Longe's study shows that governemnt expenditure in Nigeria has been on the increase, and this was against the back drop of declining non-oil export revenue.

2.3.1 Export of Manufactures:

The extent to which Nigeria succeeds in boosting export of manufactured goods surely depends on the elimination of the crippling problems of industry: serious capacity underutilization, high import content of industrial output, low value-added, high cost of production and low level of foreign investment in manufacturing (FGN, 1988:10). Other issues are availability of and access to foreign exchange, protectionism and conducive investment climate.

One failure of Nigeria's export drive is the steady decline in capacity utilization of manufacturing companies and in some cases outright closure of companies. The situation was highlighted by the Manufacturers Association of Nigeria (MAN) half-yearly economic review for 1992 (African Concord, 1992; Financial Guardian 16/11/93) in which it reported a 48-percent decline in production capacity utilization.

The exchange rate deregulation policy placed hope on the relative prices to stimulate export. The hope appeared to be misplaced, as exports depended among other things on export capacity and demand. That export volumes depend on these rather than on price was underscored by the International Monetary Fund in its defence of a fixed exchange rate system in

the post war effort to establish a stable world financial system. (Scammell, 1975:141; Oyaide, 1982; Abdullahi, 1985; Osaigie, 19 :166)

Underneath the declining capacity utilization in industry are the negative effects or dysfunctions of monetary policy: high cost of funds arising from interest rate deregulation and crash in the inter-bank lending rate and tight monetary policies. These have raised the cost of production and adversely lowered the availability and access to credit for manufacturing companies at a time they need more (not less) working capital because of inflation and rising cost of inputs. (Business Times. 19/7/93, 5/7/93, 12/7/93, & 13/9/93).

Thus it is contended that the various efforts by the regulatory authorities designed to bring sanity to the financial system and the economy tended to aggravate the problems of both (Business Times 26/7/93). The real sectors are reported to be stagnating or dwindling. What was in boom were the banks a lot of which were promoted mainly to trade in foreign exchange, transportation and placing depostis; and supplies contracts (Business Times 10/5/93, 28/3/94)

This highlights the low contribution of industry to the gross domestic product of about 10 percent despite its consumption of about 60 percent of the total foreign exchange allocation (Business Concord, 19/4/94) and a growing number of incorporated companies on a daily basis.

The greatest barrier to the export ambition of Nigeria has been the export or international market itself.

Since after the second world war the basis of capitalist economic relation has been laid in a libreral and multilateral system of international trade and payments which were promoted by the International Monetary Fund and the General Agreement on Trade and Development (GATD). It was built on the

idea that nations are free to trade with one antoher under conditions of free convertibility of currencies and abolition of tariffs and other restrictions which are qualitative. Obadan (Business Times, 16/8/93) argued that this trade from which Nigeria adopted liberalization of trade and free market has been riddled with many malpractices such as overinvoicing, unfair pricing, transfer of foreign exchange for which goods are not supplied that Nigeria and so many developing countries have been saddled with inflated, fictitious, and dubious debts.

The conduct of the trade which was heavily oriented to the industrial world did not encourage equal participation and mutuality of benefits. Our manufacturing sector was incapacitated from contributing to the flow of manufactured goods to the market as the deregulation of the foreign exchange market made it impossible to obtain production inputs at affordable prices. The manufacturing sector was crippled. It was cheaper and more profitable to import finished consumer goods.

For example, importation of manufactured goods increased from ₦846m in 1984 to ₦5803 million in 1989. For the same period export of manufactured goods only increased from 12.4 million to ₦176.90 (CBN 1990:140 & 141). In fact, exports even declined to ₦1.7 million in 1986 from ₦12.4 million in 1984. Trade debts increased from ₦47,593.1 million in 1987 to ₦77, 174.9 million in 1989. Total Federal external public debt rose from ₦100,789.1 million to ₦..2,750.7 million or 58.8% in the same period.

The share of manufactured goods export accounted for only 0.30% of the total exports in 1989. These statistics confirm the observation that industrial development in Nigeria and other Third World countries based on exports to the industrial world faces crippling barriers (Killick, 1981:189; Business Times, 10/5/93; Toffler, 1981:100 & 101; United Nations cited in Corbridge, 1988:40; Abubakar, 1987:240).

It was the awarness of these limitations that led the Economic Commission of Latin America (ECLA) spearheaded by Raol Prebisch to advocate a strategy of import substitution industrialisation (ISI); that Third World countries will be justified in protecting their infant industries behind tariff walls (rather than Nigeria's romance with international competition) until they could compete freely in the world market and secure the industrialization which would bring with it the development externalities absent from primary commodity-based growth. (Corsbridge, 1988:33-36).

The operation of the deregulated foreign exchange system and the supplementary monetary policies worked to cripple the manufacturing companies. Most of them accumulated non-performing credits. Business Times (4/4/94) reported that banks were reluctant to create credits for the manufacturing companies because of non-performance of existing credits in the banks' investment portfolios at a time they needed more working capital.

The evidence emerging from the available literature seems to show that the deregulation of the foreign exchange market was not able to resolve what has been identified by Abdullahi (1987:67) *as a production crisis in the Nigerian* manufacturing sector. It is a crisis of the inability of the sector to expand production rapidly enough to meet demand.

Part of the crisis has its origin in the larger problems of industrial underdevelopment contrived by metropolitan capitalism. According to Baran (cited in Corsbridge, 1988:35) industrial development in the Third World is resisted because it is perceived to be profoundly inimical to the dorminant interests of the industrial countries. He believes that we are trapped in a capitalist world economy which is assymetrical, unequal and repressive.

In Wallerstein's model of surplus transfer, actors in metropolitan capitalism call on their state machines to deliberately and persistently weaken the periphery (developing countries) by conquest, monopoly pricing, and protectionism.

(Wallerstein cited in Corsbridge, 1981:37). This is achieved through free trade and resource exploitation. (Hoogvelt, 1982:140; Woodruff cited in Toffler, 1981:109)

Another is what Professor Kayode (Business Times 19/4/94) called problem of strategy. He believes that Nigeria's problem is not one of foreign exchange but that of strategy.

Abdullahi (1987:67) believes it is a problem of dependent capitalist development which requires radically different prescription. Even the Federal Government officially acknowledged the import-dependency of the country's economy and that the Structrual Adjustment Programme has not been able to reverse it (Ahmed, 1993:23).

2.3.2 Export of Agricultural Produce

The obstacles to a fair and beneficial participation in the export market for manufactured goods also affect agricultural produce.

In assessing the role of deregulation of foreign exchange market in agricultural exports, attention must be paid to issues of the prices of agricultural produce and the conflict in raising the terms of trade and relative cheapness to encourage external demand. The issue of the development of synthetics as substitutes and the limits to export volumes as evidenced in the glut and collapse of the primary products market are worth examining.

Most of the improved inputs that were needed by the farmer to increase output were imported. At the rate of exchange of the naira which stood about ₦33.00 to U.S. $1.00 up from ₦2.50 around 1982, the cost of the inputs appeared to more than offset the higher prices offered producers. (Abalu and Ingawa, 1987:153). Depreciation of subsidy on farm inputs

such as agro-chemicals and farm equipment escalated production cost. (CBN 1991:66).

Heuristic information (data) from small scale and subsistence farmers give a fair indication that total cost of production was widely believed to exceed farm incomes, and at best only reached breakeven levels.

We were fortunate to discuss with some farmers who agreed that when cost of own labour is imputed into total cost of production farming would appear to be an unprofitable activity. Substituting this for the export produce farmer, one immediately visualizes a futile export effort.

Central Bank of Nigeria (1991:68) reported that developments in the world commodity market for Nigeria's major agricultural export commodities were mixed during 1991. The all-commodities world price index calculated in U.S. dollars rose by 5.3% to 107.2 (1975=100). In terms of naira, the prices rose sharply because of the persistent depreciation of the naira exchange rate. But the prices of some produce actually fell. For example, cotton (8.1%), coffee (6.3%) and groundnut oil and soyabeans (1.3%).

In effect, the price incentive which was expected to encourage production was not achieved. The price increase recorded for cocoa was as a result of a marked decline in output in Malaysia because of a severe drought that hit that country and 'pod rot' in Bahia cocoa growing area in Brazil.

World Bank Report (cited in Morgan, 1988:80-83) of 1986 stated that the effects of the policies of the industrial countries has been to depress world agricultural produce prices and to distort the ralative prices of agricultural (and manufactured) goods. Thus the developing countries' competitiveness depend less on their own efficiencies and more on political decisions in the industrial countries.

Demand for some of Nigeria's agricultural exports in 1991 fell. Central

Bank of Nigeria (1991:68) report revealed that there was a general state of over-supply in the market, ineffectiveness of international commodity agreements and the availability of substitutes. Another reason for the decline in demand was the recession in the developed world. Rubber in particular suffered low demand because of the general recession in the automobile industry. It is worthy of note that the decline in effective export is on an already paltry export base. In percentage terms, agricultural export was an average of 2.59% between 1984 and 1989. Growth rate had shivered between -66.7% and 45.4% for the same time period. The largest decline in growth rate of -66.7% was recorded in 1981. For the 1985-1989 period, growth rate was an average of 2.6%. (Omoruyi, 1990:53).

The observations of the United Nations Conference on Trade and Development (UNCTAD cited in Abubakar, 1987:236) hold for Nigeria: "For most commodities, the earnings of developing countries as a whole can be increased only if volumes are controlled. This result cannot be brought about by market forces alone. Indeed, if producers respond positively to price incentives, and if governments rely on currency devaluation to clear the market for foreign exchange, there is a danger that the resulting expansion of output will so reduce the price of commodity exports that inbalances in external payments will actually increase".

It continued that "volume control requires collective action by producers. In its absence uncoordinated attempts by exporters of primary commodities to balance their external payments through programmes entailing devaluations may well worsen over-supply in many commodity markets and exacerbate rather than reduce developing countries' deficits in current account".

Agricultural productivity has been identified with strutural adequacy issues. That is, productivity depends on the trends in land tenure, land holding distribution, fragmentation and subdivision; land reform policies, system of

renting, leasing and share cropping. There are also related problems such as extension services, development of high quality management, the quality and experience of the farmer which are major elements in decisions to innovate and willingness to take risks. Thus a policy for agricultural improvement must therefore deal with much more than agriculture to be successful and offer a plan for a change over a wide range of social, economic and political activities. (Morgan, 1988:107-108).

In Nigeria, 90 percent of the total land cultivated is in the hands of the small scale farmer who accounts for 90 percent of the total agricultural outpu . The steady out flow of able-bodied farm workers and ageing of rural farming population are serious contraints to agricultural improvement, and the strategies mapped out by government to contain them such as backward integration and back-to-land (FGN, 1988:21-23) are weak in relation to the enormity of the problem.

Agriculture has been regarded with a low esteem right from time and this perception has persisted over the years. In Nigeria, expectations have been raised and transformed to the point that young people are looking for an escape from agricultural employment. Higher wages in industry and services provide an attraction with even a waiting period of several years of unemployment (Morgan, 1988:82). The Commission on Post-School Certificate and Higher *Education in Nigeria decried the low esteem accorded agriculture (cited in* Fafunwa, 1974:176).

Government's hope in the Agricultural Development Programme (ADP) to contain the structural problems in agriculture particularly the dominant small scale farming subsector has been misplaced as it turns around to benefit "large scale progressive farmers" using their political contacts to take advantage of the services and facilities offered by the projects. The package approach of the ADP to agricultural development narrows down the adoption of the programmes by farmers. Only farmers with high level of sophistication benefit from the

package and they are very few. (Voh, J.P; Silva and Raza cited in Abba et a. 1983:28).

Although there is a good list of agricultural research institutions, river basin development authorities, agricultural development institutions such as ADPs, and Directorate of Foods, Roads and Rural Infrastructure (DIFFRI); agriculture finance bank (Nigerian Agricultural and Co-operative Bank), the impact on productivity is not commesurate with the investment. The major problems highlighted by the Agricultural Research Institutes were inadequate funding and late release of approved funds. High cost and scarcity of research materials such as equipment and chemicals also constrained research efforts. (CBN, 1991 : 71).

2.4 Bank Liquidity and Foreign Exchange Market:

Excess liquidity is believed to exist in the economy and the banking system and said to be exerting persistent demand pressure on the official foreign exchange market and responsible for the persistent depreciation of the naira and instability in the exchange rate of the naira. (CBN, 1990 : 32). The same was blamed for the overheating of the economy and resultant inflation.

Thus instead of controlling price, the Central Bank of Nigeria demonetized about ₦6,6 billion imports deposits with the banks awaiting foreign exchange cover. (CBN cited in Nwakwo, 1990 : 66). The excess liquidity was determined from banks on average monthly liquidity ratios of 57.3 maintained compared with the prescribed 25per cent. By December, 1990, the Central Bank of Nigeria had mopped up ₦9.18 billion from the banking system through the issuance of stabilization securities. As Ntekop (1992 : 21) explained, the mop-up exercise was intended to reduce the purchasing power of the target foreign exchange dealers with a view to lowering their high bid rates to shore up the value of the naira.

If the pressure on the foreign exchange market, and the depreciation of the

naira and volatility of the naira exchange rate were due only to the liquidity in the banking system, then the policy measure would have achieved its objective and all should have been well with the economy.

An analysis of the exchange rate movement (1986 - 1992) shows that the naira exchange rate worsened from 1991 after a series of liquidity mop ups. The rate was ₦4.6174 in September, 1986 and climbed to its peak of ₦18.6000 to US $1.00 in April, 1992. (Ntekop, 1992 : 28). The worst came in 1993 when the rate hit about ₦32.0000 to one U.S. dollar.

Other monetary policy measures were adopted by the monetary authorities to reduce the liquidity in the banking system. The Central Bank compelled banks to deposit in a non-interest bearing deposit account, the naira equivalent of all outstanding external payment arrears. A total of ₦4.2 billion was deposited. Credit ceiling of 10 percent expansion was imposed on the banks in 1986 and later reduced to 7.4 percent in 1987. By Treasury circular of May 26th, 1989, all government accounts were pulled out from commercial banks to the Central Bank of Nigeria. Most pungent was the abolition of foreign guarantees/currency deposits as collaterals for naira loans. (Ojo, 1992 : 10 & 11).

It was observed that bank lending and deposit rates rose sharply in 1989 following the intensification of the measures to reduce the liquidity in the banking system (Olekah 1991). This had to be so because some banks became illiquid and borrowed at distress and sourced deposit with desperation to shore up their liquidity position. It was a period of short-lived financial instruments.

For purposes of analysis it is the impact of the liquidity management measures on the economy that attracts attention. For the most part, this was negative, counter productive, and dysfunctional.

Anyanwu (Business Times 19/7/93) has pointed at the serious consequences of

the measures for bank customers and the borrowing public as interest rates were forced up dramatically raising the cost of funds, cost of production for manufacturers. As the industries' working capital needs increased banks were unable to meet their funding needs.

In the observation of Nwankwo (Business Times 2/8/93) the liquidity mop up is a violent physical means of controlling liquidity and interest rate instead of relying on market incentives. Of particular concern is the way it encouraged speculative money market investments as the money market operators took advantage of frequent short-term hikes in interest rates. Hence resources were diverted from long-term investments to short-term businesses such as financing local purchase orders on profit-sharing basis.

This is one reason why bank lending to prioritized sectors (agriculture and manufacturing) as enunciated in the Monetary and Credit Guidelines falls short of the prescribed ratios. But they always exceed the ratios prescribed for the less prefered sectors (for example, domestic trade) (Nwankwo, 1990:60 & 61). In a rather innovative manner, banks were alleged to have tried to circumvent the credit ceillings by acting as brokers between owners and borrowers of funds which tended to diminish the efficency of the financial system (Ojo, 1992).

The credit ceillings tended unwittingly to hamper banks' real lending. Because of the growing accumulation of bad and doubtful debts in the banks' investment portfolio, efforts to keep the ceillings gave rise to freezing of lending to the public. Busting of the ceillings became frequent as it was a necessity for the survival of both banks and the borrowing public. At the same time, it appeared that the monetary policy was inappropriate or dysfunctional.

It appears that the issuance of stabilization securities which mopped up some ₦21.9 billion as at September, 1992 created the widely reported illiquidity in the banking system. A crisis point was reached when the Chartered Institute of Bankers of Nigeria (CIBN) threatened to withhold full participation in the open market operations arguing that they would be cash-strapped if the Central Bank of Nigeria failed to pay banks about ₦36.0 billion it held in stabilization securities. (Business Times 12/7/93). The National Union of Banks, Insurance and Financial Institutions Employees (NUBIFIE) threatened to and did instruct their members to stay away from work to protect them from desperate customers who might be violent (NUBIFIE). And it was reported that there was a run on the banks in Lagos as banks were unable to meet their clients cash demands. (Business Times 23/8/93) Cash rationing by banks in Lagos was widely reported in the news media.

The measures appear to be drastic and violent as they were executed in a setting that lacked the necessary money market base for managing the banks' liquidity needs. Many banks were compelled to borrow in the interbank market at distress resulting in repayment default despite rolling over such matured credits. Thirty Seven (37) banks were serious defaulters. The money market Association of Nigeria was compelled to list these and circulated the list to healthy banks not to deal with them. (Business Times, 15/11/93)

The money market lacked both in number of tradeable/marketable securities (instruments) and volume of operations. For example, the marketable securities normally traded include treasury bills, treasury certificates, development loan stocks, certificates of deposits, first class eligible commercial papers, securities purchased under agreement to resell (Repos). Others include government bonds, bankers' unit funds and floating notes sold. Of these the best known and most traded are treasury bills and treasury certificates. Government bonds are not common. Development loan stocks are

issued by the Federal Government. The extent to which the others are used is difficult to determine or not known. (Nwankwo, 1990:79)

For example, as at close of the fourth quarter of 1991, commercial banks held only ₦559.3 million of the total of ₦34,214.6 million treasury certificates outstanding. Central Bank of Nigeria held ₦32,813.3 million worth of treasury certificates. For treasury bills, the commercial banks held only ₦6,254.2 million worth against the ₦34,756.0 million of the Central Bank of Nigeria for a total holding of ₦56,728.3 million. For development stocks of ₦4,221.0 million, commercial banks held ₦33.5 million, merchant banks held ₦6.7 million. Central Bank of Nigeria alone held ₦807.9 million. (CBN, 1991:48-51)

To these may be added the absence of a discount house that would have provided a secondary market for marketable securities. Oke (1992) highlighted the role of discount houses in liquidity management of the banking system. In their daily operations, the banks can meet shortages of funds by drawing down their deposits with or borrowing from the discount houses. They can also deposit surplus funds with or use them to buy additional marketable securities from the discount houses while the Central Bank acts as lender of last resort to both the banks and discount houses.

In the absence of these, banks may be justified in warehousing their liquidity above the prescribed percentage to serve as a line of defence to be mobilized in times of need to support crisis management. The cash ratio which is statutorily designed to serve as a line of defence has a drawback in that only excess holdings over the statutorily prescribed levels are available to meet liquidity needs. (Nwankwo, 1990:81)

Thus 'excess liquidity' may be a reasonable defence strategy for banks. The situation is similar to that created by the Banking ordiance of 1952 which drew the criticism of the nationalists. They criticised the ordinance which required the banks to maintain adequate liquidity but

did not provide investible money market assets. The indegnous banks operated at a heavy loss by maintaining their liquidity in barren cash. (Nwankwo, 1990:19)

The liquidity management measures by the monetary authorities may not be the best available. They rather appear to be designed for crisis management in the foreign exchange market: Because of the dwindling foreign exchange earnings, demand for foreign exchange persistently outstripped its supply fueling a demand pressure on the market. The government lacked and still lack the capacity to provide the foreign exchange requirements. So, supply management was certain to be unsuccessful and futile. Demand management therefore became an attrative option.

In this, they had some success: In addition to the mopping up of ₦9.18 billion from the baking system as at March 20, 1991, the Central Bank of Nigeria issued a directive to the Authorized Dealers to fund their accounts to cover their foreign exchange demand in the market and that any bank that violated the regulation was to be barred from the foreign exchange market for four (4) weeks. The number of participants in the market on April 10, 1991 reduced as 18 banks were barred apparently because of their illiquidity. (Ntekop, 1992:23) It did not reduce foreign exchange needs of the real sector.

It is unfortunate that the demonetized deposit for foreign exchange represented working capital of companies that needed the foreign exchange to import raw materials.

It was observed that the liquidity mop ups positively correlated with budget deficits of government, giving credence to the conclusion that the monetary authorities were only using any means to accommodate the fiscal excesses of government. (Nwankwo, 1993:5)

2.5 Exchange Rate Deregulation - Comparative Analysis

Nigeria did not invent floating exchange rate system. Countries Countries that have adopted floating exchage rate include Canada, Ghana, Zambia, Jamaica, France, and the United States of America.

(i) Canada:

The earliest important case of a major economy adopting a free rate of its currency was Canada in 1950. It was aimed at checking the speculative inflow of capital generated by favourable reports that her currency was undervalued and economic position strong. The experiment was a huge success with a narrow range of fluctuation of the currency despite the sensitivity of the rate to trade balance changes. (Scammell, 1975:147) In 1962, the currency was returned to a fixed parity until 1970 when she once more freed her currency.

It seems to indicate that there is nothing inherently good or bad about either fixed or floating exchange rate system. Both are useful for achieving a desired policy objective. It therefore should require a correct determination of the need policy end would serve. This should determine whether exchange rate policy is the tool required to solve the problem identified, and the appropriate exchange rate regime.

(ii) Zambia:

Zambian authorities experienced considerable difficulties in implementing the IMF - supported structural reform since 1976 with exchange deregulation as major strategy.

Growth in output suffered persistent decline between 1981 and 1984 but recovered marginally by 1.5 percent in 1985. However when the reform programme was cancelled in 1985 and replaced with a new home grown New Economic Recovery Programme in 1987, growth in output resumed. This was short-lived as the economy suffered setback: Inflation worsened, external debt rose sharply as with the debt service ratio.

The persistent decline in the price of copper in the world market was identified as the main cause of the poor performance of the external sector. (Omoruyi, 1990) Cheapness of export good did not translate into infinite demand and exchange revenue.

The devaluation of the Kwacha largely placed many businesses at the precipice of bankruptcy, and increased the cost of living. Thus a mealie meal riot broke out in 1986 which led to a reversal of the earlier price increase of maize which was 500 percent. (Abdullahi, 1987:66)

(iii) Ghana:

Ghana's implementation of the economic recovery programme since 1983 was said to be a success story. Agricultural output increased between 1983 - 1988. This was assisted by favourable weather conditions; price incentives and improved world cocoa prices. The balance of payments improved as export volumes increased remarkably by an average of 10 percent between 1987 - 1988. Inflationary performance was significant but overshor + official target reflecting the effect of the deregulated flexible exchange rate policy (Omoruyi, 1990)

In the evaluation of Abdullahi (1987:66) exchange rate deregulation in Jamaica, Zambia, Ghana, and Bolivia is like plugging into a bottomless pit which generates a momentum of its own:

In Jamaica, the operation of the system was not able to eliminate balance of payments deficit as it did neither boost exports nor contain the growth of imports. (Wilter cited in Abdullahi, 1987:66).

These results led to Wilter's criticism that devaluation/exchange rate deregulation attempts to solve what is in effect a crisis of production in the sphere of the external account but not the production itself which proves the observation of persistence of the crisis in many cases even after a series of devaluations.

A common feature of the exchange deregulation regimes is that they are imposed by the World Bank and the International Monetary Fund which by virtue of the vast amount of resources they control, monopoly of information, and position of the gateway to western support have become a dominant power in economic management in Africa. (Ake, 1994)

And it would have been surprising if these had succeeded: The strategy/instrument designed to implement the Structural Adjustment Programme SAP) is characterized by allienation from social experience, social needs and social will. Ake remarks that because the Structrual Adjustment Programmes are so draconian, they are assumed to require imposition; their failure appears sealed because they break down social consensus, cause violent conflict, anxiety and deep despair and sometimes premature death on a large scale particularly among children.

He pointed out that these grim effects of policy reform can only be inflicted by people who do not belong to the adjusting society or those who are sheltered from/or immune to them.

2.6 Exchange Rate Deregulation: Alternatives To Foreign Exchange:

The limitations of the floating exchange rate system are very well known. In fact the failure of the floating exchange rate system in terms of the distribution of burden and benefits have been so unsatisfactory that the five major developed capitalist countries met on September 22, 1985 and resolved that currency values (exchange rates) should no longer be determined by market forces only. The system has been regarded a a temporary measure until a lasting solution could be found to the international monetary crisis. (Felegan, 19 :229)

Killick (1981:207-208) suggests that since few developing countries have sufficiently developed foreign exchange markets for floating of the exchange rate to work, if it is desired to use exchange rate as an instrument of policy, then the method of continuous adjustment is to be preferred. The benefits of this method are that it is easier to adjust to continuous changes, less likely to permit payment crisis to develop; provide fewer incentives to destabilizing speculation and requires few resources to be locked in foreign exchange reserves.

Obadan (Business Times, 16/5/93) argues in favour of counter trade as a way of getting out of the present economic problem. His argument has two attractive points: that it allows international trade to take place where it would otherwise have not taken place because the countries involved do not have foreign exchange. It is also a bilateral means of balancing a nation's current account, especially for countries hit by falling commodity prices or protectionism by industrial trading partners.

The system of trade described here is bilateralism. It is widely

practiced. Developed countries too are reported to practice it in order to solve the problem of excess capacity. Among these countries named by Obadan are America, France, Britain, Italy and New Zealand. An increasing number of developing countries facing depressed commodity prices, chronic foreign exchange shortages, growing trade imbalance, dwindling credit lines and huge external debt have resorted to counter trade.

Nigeria flirted with counter trade in 1984 but abandoned it apparently because it was discredited by the proponents of multilateralism. Arguments raised against counter trade/bilateral trade are that it constitutes a retreat from multilateralism; that it limits the volume, character and efficiency in international trade, and that it engenders beggar - thy - neighbour syndrome and uncontrolled importation of goods which retards local innovation. Well, multilateral trade is no better. Worse, the benefits of expanded trade/ multilateral trade have not been evenly shared by all the parties. They flow from the first (agricultural, raw material producing) world to the second (industrial). (Toffler, 1981:101)

Afterall it was chronic unemployment, cycles of boom and bust, excess capacity and underconsumptionism of capitalist economies that fired European colonial ambition in search of (world) market and cheap raw materials. (Toffler 1981 :98; Baran cited in Corsbridge, 1988:36)

Import substitution industialization has been suggested by Teiltel and Thoumi (cited in Ndebbiu, 1987:95) as a necessary transition to promote investments for exports. They believe that the emergence of exports results from subtitution stages characterized by fairly large domestic markets for industrial products, ample supply of agricultural and livestock resources and relatively elastic supplies of skilled and unskilled industrial labour.

Admittedly import substitution has been tried and failed to work in a number of Third World Countries. Onimode (19 :194 & 195) attributes the failure of import substitution industries to the wrong products produced and the

powerful obstructions mounted by the multinational corporations: Frenetic advertising, constant product differentiation, global distribution and sophisticated marketing with the "international demonstration effect" of imperialist consumption habits to which Third World states are exposed.

The question is not whether industrialization is necessary. Nehru (cited in Longe, 1993) identified that "real progress (in the Third World) must depend on industrialization". The question is how to approach our industrialization and whether foreign exchange is inevitable for industrialization to take place.

Onimode (1987:142) argues that the role of foreign exchange in economic development in Nigeria is exaggerated and the quest for it at all cost distorts the development process. It compels export-led, extroversive development orientation that depends for its success on external factors over which we have no control or virtually no influence.

Ake (Financial Guardian, 1994) observes that the world is changing in ways that make endogenous development objectively necessary. He believes that this does not call for another new initiative in economic development. This seems to appeal to import substitution/displacement strategy - in raw materials development, and final and intermediate goods manufacture.

It is not that import substitution/displacement eliminates importation per se. It should aim at reducing the classes of imports such as raw materials available or can be developed and finished goods being imported that can be produced locally. Importation then should concentrate on capital goods which we have not been able to or cannnot produce now. Then bilateral trade arrangements should be used for these essential classes of imports.

Finally we should reorient the industrial sector. We started out with import substitution industrialization which is import-dependent and foreign exchange consuming. The industrial reorientation programme should place emphasis on the development of capital industry: prime movers, machine tools and tools, heavy duty machinery, equipment, and appliances. Al-Abba et al (1985:68) advise a National Machine Building Corporation as the agency to achieve this objective. The industrial sector should be structurally integral to achieve development.

CHAPTER THREE

ANALYSIS OF DATA AND RESULTS

3.0,0 Analytic Statistical Model:

Data were analysed on the computer based on the regression model:

$Y = a + bX_1 + bX_2 + bX_3 + bX_4 + \ell$

where,

Y = dependent variable - demand for foreign exchange

a = a constant, the interception on the y-axis

b = the gradient of the regression line and is the ratio of the change in y to a change in X; the degree of responsiveness of (demand for foreign exchange) to a change in X (independent variables). It is the regression coefficent.

X_1 = independent variable $1(IV_1)$ - supply of foreign exchange

X_2 = independent variable $2(IV_2)$ - bank cash, and account balances with the Central Bank of Nigeria.

X_3 = independent variable $3(IV_3)$ - imports

X_4 = independent variable $4(IV_4)$ - private capital outflow.

ℓ = an error term that is the residual value of the regression equation.

The interaction between the dependent variable and each of the independent variables is captured in the equations,

$Y = a + bX_1 + \ell$ ..... (1)

$Y = a + bX_2 + \ell$ ..... (2)

$Y = a + bX_3 + \ell$ ..... (3)

$Y = a + bX_4 + \ell$ ..... (4)

All of these equations condense to the general form,

$Y = a + bX_i + \ell$

where,

Y = dependent variable plotted on the vertical axis

a = intercept on the vertical y-axis

b = regression coefficient or gradient of the regression line

X = independent variable

i = the number of independent variables such that $i = 1, 2, \ldots, n$.

ℓ = error term, a measure of residual value of all the variables not included in the equation.

The expected output from the computer comprise the regression coefficients with the independent variables (bX_i), the coefficient of determination (R^2) which is a measure of the percentage explanation provided by the independent variables studied and the residual value obtained by subtracting the coefficient of determination from 100; ($100-R^2$).

Based on the model developed above, the raw data (Table 1) were fed into the computer, analysed and produced the equation:

$$DV = 67694 + 1.19IV_1 - 2.70IV_2 + 0.630IV_3 + 7.33IV_4$$

where,

DV = dependent variable ~ demand for foreign exchange

a = 67694

The equation also shows the independent variables (IV) from 1 to 4 with their regression coefficients. R^2 is 91.1% and the residual value is 8.9%.

The results of the Pearsons (r) and regression analysis are displayed in tables 2 - 5, and the time-series graphs are shown in figures 1 - 5.

In what follows below, we describe the results:

3.1.1 Hypotheses One:

The null hypothesis stated that there is no significant relationship between the demand for and supply of foreign exchange.

The Pearsons (r) correlation coefficient of the relationship between them was 0.796. The result was checked against the table Pearsons (r) at the critical level of = 0.05 with a degree of freedom (df = N - 1) of 11. The table value was found to be 0.553. The calculated Pearsons(r) exceeded the table Pearsons (r).

The result indicates that there is a significant relationship between the demand for and supply of foreign exchange. Therefore, the null hypothesis was rejected.

To determine if a change in the supply of foreign exchange led to a change in the demand for foreign exchange, we checked the t - ratio obtained from the computer analysis against the table

TABLE 1: MATRIX OF VARIABLES IN THE DEMAND FOR FOREIGN EXCHANGE (₦ MILLION) AND EXCHANGE RATE MOVEMENT ANNUALIZED (1980 - 1991)

YEAR	FOREX RATE	FOREX DEMAND * (DV)	FOREX SUPPLY (IV_1)	VAULT CASH & ACCOUNT BALANCES (IV_2)	IMPORTS (CIF) (IV_3)	CAPITAL OUTFLOW (PRIVATE) (IV_4)
1980	0.5469	100,344	9475	2541	9096	319
1981	0.6052	120,132	15321	2511	12599	447
1982	0.6731	97,484	12708	3142	10100	569
1983	0.7506	110236	11330	2790	6556	1117
1984	0.7672	95849	8943	2262	4485	851
1985	0.8924	98334	10,463	2067	5537	1094
1986	1.7323	101010	11229	6197	5975	1524
1987	3.9691	124103	20918	10579	15695	4431
1988	4.5367	133675	28612	16242	18088	4891
1989	7.3651	140451	49563	19587	25178	5132
1990	8.0378	151248	72958	20913	45717	435
1991	9.9132	91147	30799	29442	69083	595

SOURCE: Statistical Bulletin, Lagos: Central Bank of Nigeria, 1990

* Collated from foreign exchange reports.

Table 2: RESULT OF ANALYSIS OF PEARSONS (r) PRODUCT MOMEMENT CORRELATION AND MULTIPLE REGRESSION ANALYSIS ON MATRIX OF FACTORS IN THE DEMAND FOR FOREIGN EXCHANGE
(1980 - 1991)

FACTOR	PEARSONS (r) Coeff	REGRESSION Coeff	t - ratio
Supply oi Foreign Exchange (IV_1)	0.796	1.1943	6.56
Vault Cash & Account Balances (IV_2)	0.415	- 2.696	- 1.61
Import (CIF) (IV_3)	0.209	0.6299	0.66
Private Capital Outflow (IV_4)	0.536	7.336	2.32

2 - Tailed; N = 12; Df : 11;

TABLE 3

SUMMARY OF HYPOTHESES AND DECISIONS BASED ON
RESULTS OF PEARSONS (r) CORRELATION COEFFICIENTS

HYPOTHESIS	CALCULATED PEARSONS(r) COEFF.	DECISION	REASON
One	0.796	Reject	Cal (r)> Table (r)
Two	0.415	Accept	Cal (r)< Table (r)
Three	0.209	Accept	Cal (r)< Table (r)
Four	0.536	Accept	Cal (r)< Table (r)

P = 0.05; Table Pearsons (r) Coeff. 0.553

TABLE 4:

SUMMARY OF HYPOTHESES AND DECISIONS BASED ON RESULTS OF MULTIPLE REGRESSION ANALYSIS

HYPOTHESIS	CALCULATED t - DISTRIBUTION (ratios)	DECISION	REASON
One	6.56	Reject	Cal t-ratio > Table t-ratio
Two	- 1.61	Accept	Cal t-ratio < Table t-ratio
Three	0.66	Accept	Cal t-ratio < Table t-ratio
Four	2.32	Reject	Cal t-ratio > Table t-ratio

P = 0.05; N:12; Df:11; Table t-ratio = 2.20

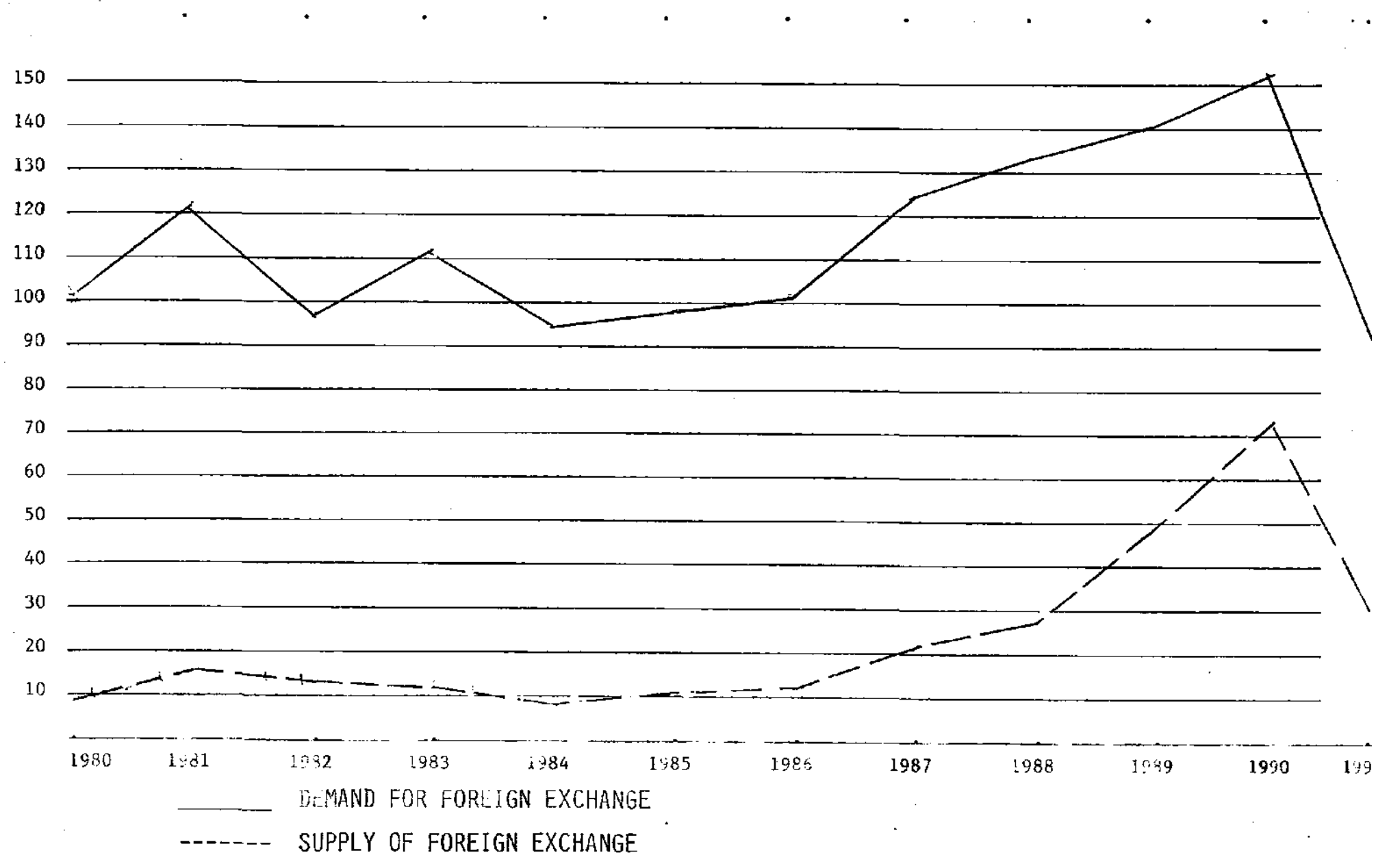
TABLE 5:

MATRIX OF INTERACTIONS AMONG FACTORS IN

THE DEMAND FOR FOREIGN EXCHANGE

	SUPPLY OF FOREX (IV_1)	CASH AND ACCOUNT BALANCES (IV_2)	IMPORTS (CIF) (IV_3)
Supply of forex (IV_1)	-		
Cash & Account Balances (IV_2)	0.760	-	
Imports (CIF) (IV_3)	0.669	0.917	-
Private Capital Outflow (IV_4)	0.245	0.325	0.045

Figure One: TIME-SERIS GRAPH FOR THE RELATIONSHIP BETWEEN THE DEMAND FOR AND SUPPLY OF FOREIGN EXCHANGE.



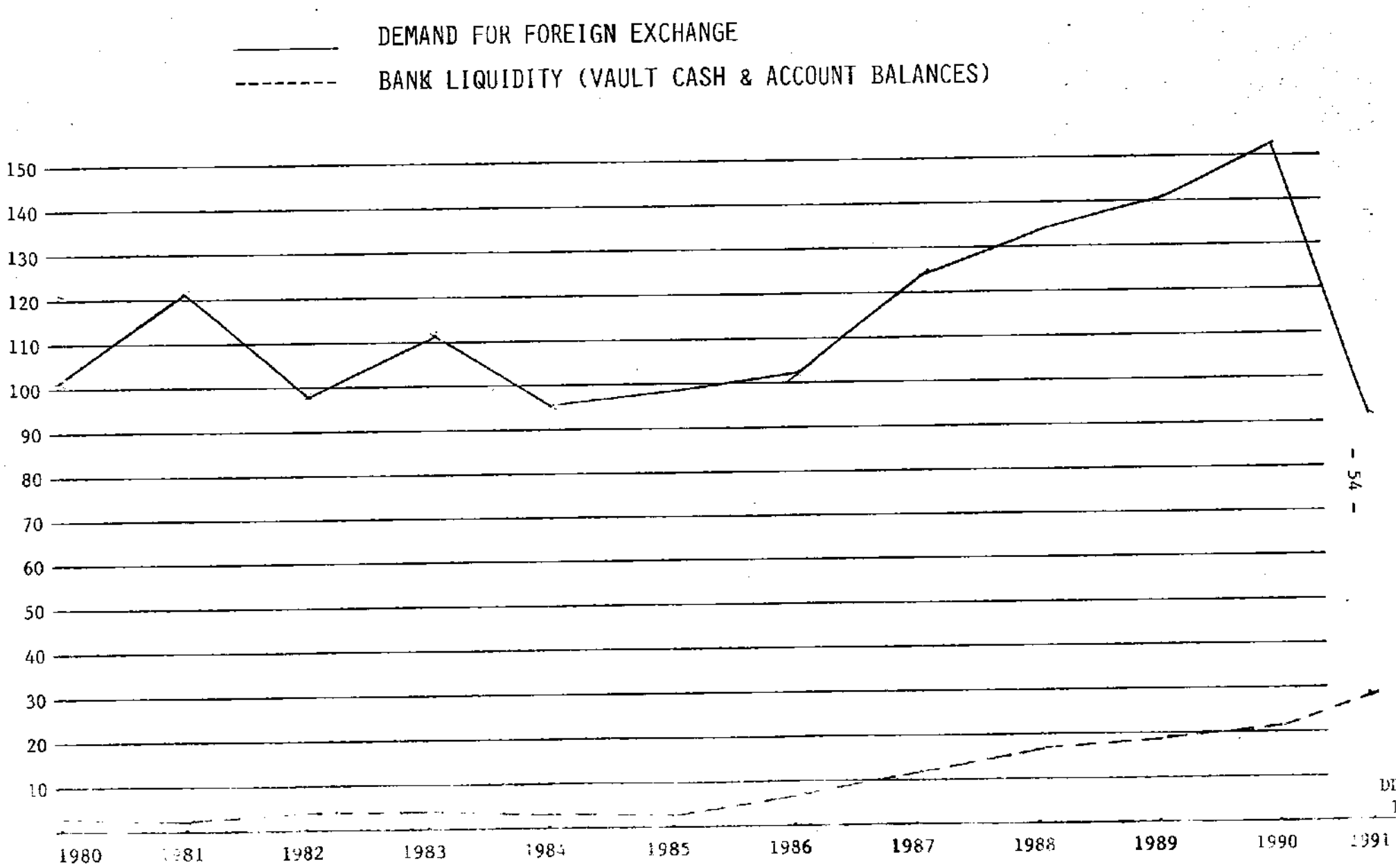


Figure two: TIME SERIES GRAPH FOR THE RELATIONSHIP BETWEEN THE DEMAND FOR FOREIGN EXCHANGE AND BANK LIQUIDITY.

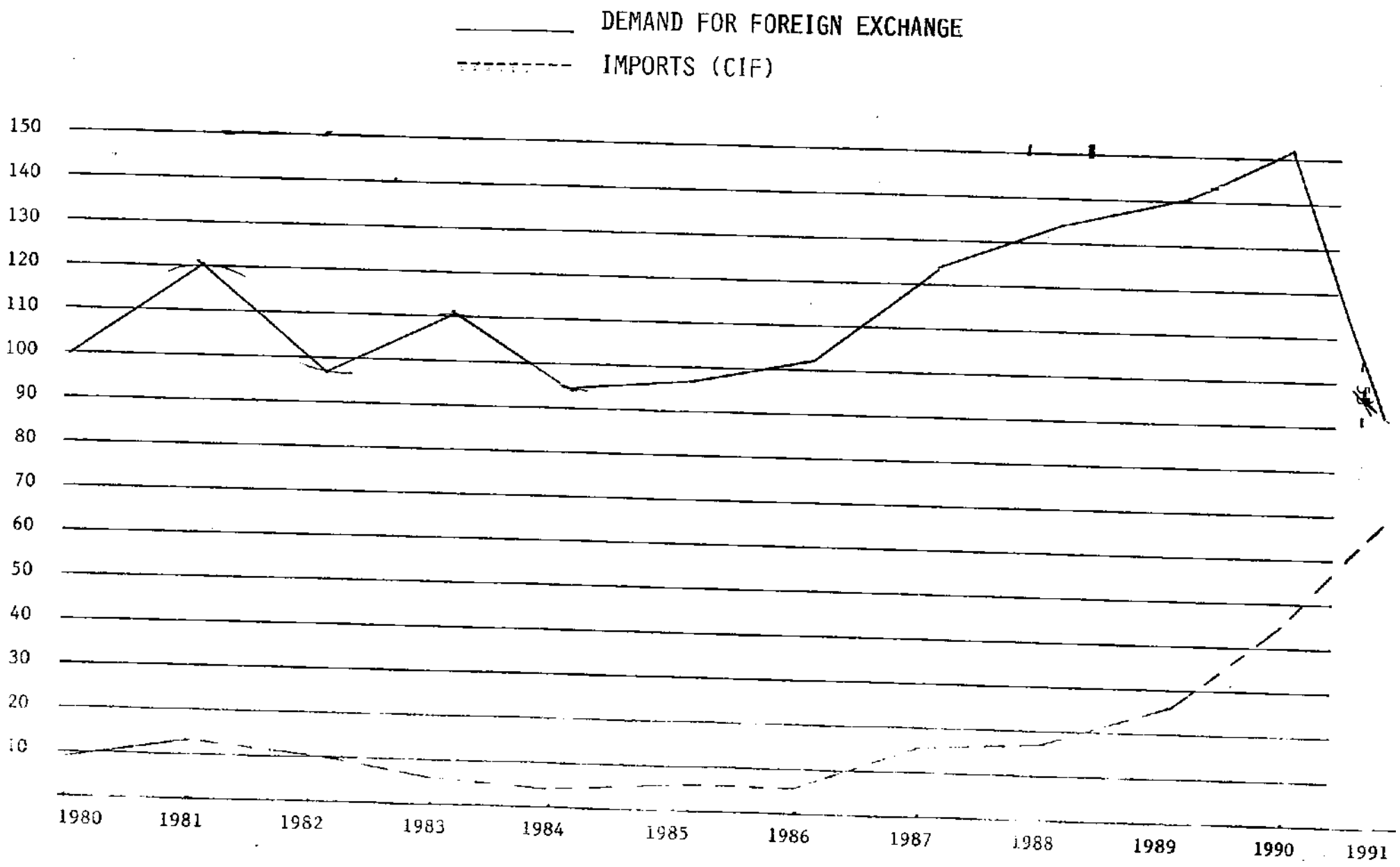


Figure three: TIME SERIES GRAPH FOR THE RELATIONSHIP BETWEEN THE DEMAND FOR

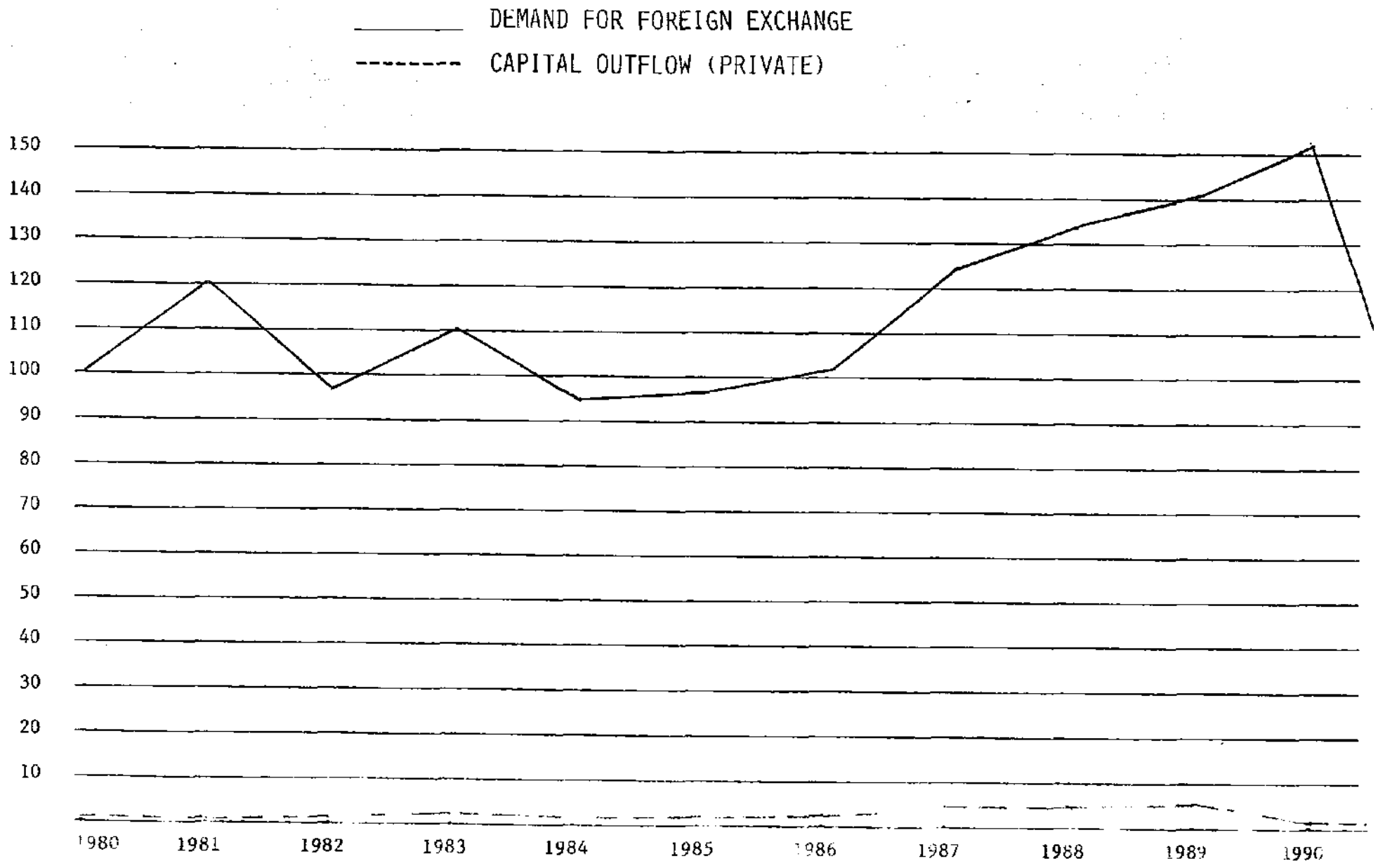
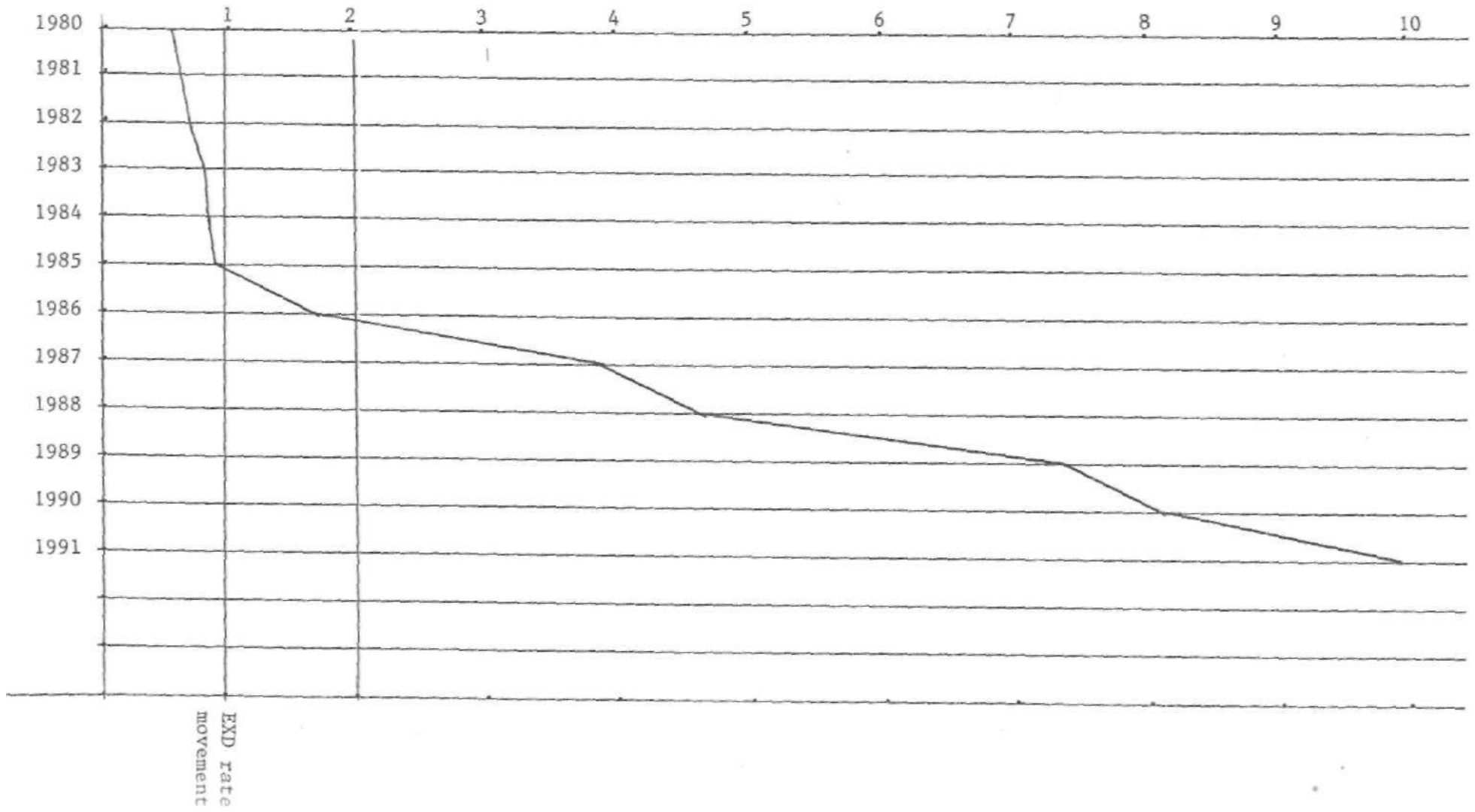


Figure four: TIME-SERIES GRAPH FOR THE RELATIONSHIP BETWEEN THE DEMAND FOR FOREIGN EXCHANGE AND CAPITAL OUTFLOW (PRIVATE)

Figure Five: FOREIGN EXCHANGE RATE MOVEMENT (1980-1991).



t-ratio at the critical level of = 0.05 with a degree of freedom (df N-1) of 11. The calculated t-ratio of 6.56 exceeded the table t-ratio of 2.20.

This indicates that a change in the supply of foreign exchange led to a significant change in the demand for foreign exchange. Thus a null hypothesis on this relationship cannot be rejected.

The results further show that we have 95% confidence that there is a significant relationship between the demand for and supply of foreign exchange and that a change in the supply of foreign exchange leads to a significant change in the demand for foreign exchange. The probability of chance that these observations do not hold is only 5 percent (P = 0.05).

3.1.2 Hypothesis Two

We hypothesized that there is no significant relationship between the demand for foreign exchange and bank liquid funds.

The computed Pearsons (r) of 0.415 was checked against the table Pearsons (r) at the critical level of α = .05 with a degree of freedom (df = N-1) of 11. We found that the table Pearsons (r) was 0.553.

The computed Pearsons (r) of 0.415 is less than the table Pearsons (r) of 0.553. This means that there is no significant relationship between the demand for foreign exchange and banks liquid funds. Therefore the null hypothesis was accepted. (Table 3)

We also checked the calculated t-ratio against the table t-ratio at the critical level of α = 0.05 with a degree of freedom (df = N-1) of 11. We found that the computed t-ratio (-1.61) was less than the table t-ratio (2.20). This means that a change in the level of banks' liquid funds did not lead to a significant change in the demand for foreign exchange. Thus a null hypothesis of this relationship cannot be rejected.

The lack of significance at the critical level of = 0.05 means that we are 95% confident that there is no significant relationship between the demand for foreign exchange and banks liquid funds and that a change in the level of bank liquid funds does not lead to a significant change in the demand for foreign exchange.

We have a probability of chance of 5% (P = .05) that this relationship does not hold.

3.1.3 Hypothesis Three

We stated in the null hypothesis that there is no significant relationship between the demand for foreign exchange and imports.

The computed Pearsons (r) was 0.209 and the coefficient of regression was 0.6299. The computed t-ratio was 0.66.

We tested the hypothesis by checking the computed Pearsons (r) against the table Pearsons (r) at the critical level of α = .05 with a degree of freedom of (df = N-1) of 11. We found that the table Pearsons (r) was .553. The computed Pearsons (r) is less than the table Pearsons (r) therefore the null hypothesis was accepted.

In order to determine whether a change in the level of imports led to a significant change in the demand for foreign exchange, we also checked the computed t-ratio against the table t-ratio at the critical level of α = .05 with a degree of freedom (df = N-1) of 11.

We found that the computed t-ratio (0.66) was less than the table t-ratio (2.20). This means that a change in the level of imports did not lead to a significant change in the demand for foreign exchange. Thus a null hypothesis on this relationship cannot be rejected.

Thus we have 95 percent confidence that a change in the level of imports does not lead to a significant change in the demand for foreign exchange and only a 5% chance (P = 0.05) that this observation does not hold.

3.1.4 Hypothesis Four

It was hypothesized that there is no significant relationship between the demand for foreign exchange and the volume of private capital outflow.

To test this hypothesis we obtained the computed Pearsons (r) and checked it against the table Pearsons (r) at the critical level of α = .05 with a degree of freedom of 11. The computed Pearsons (r) was 0.536. The table Pearsons (r) was found to be 0.553. The computed Pearsons (r) is less than the table Pearsons (r).

This means that there is no significant relationship between the demand for foreign exchange and the volume of private capital outflow. It further means that we are 95% confident that this observation holds.

We further tested for significance between the quantity of change in the volume of capital outflow and the change in the demand for foreign exchange by checking the computed t-ratio (2.32) against the table t-ratio at the critical level of α = .05 with a degree of freedom of 11. We found that the table t-ratio was 2.20.

This means that a change in the volume of capital outflow leads to a significant change in the demand for foreign exchange. So a null hypothesis on this relationship cannot be rejected. The null hypothesis here is that there is no significant change in the demand for foreign exchange for a change in the volume of capital outflow.

This result was not consistent with the result obtained when the test of significance of the relationship between the two variables was carried out

3.2 DISCUSSION OF RESULT

3.2.1 Hypothesis One:

It was hypothesized that there is no significant relationship between the demand for and supply of foreignexchange.

The hypothesis was tested. It was found that there was a significant relationship between the demand for and supply of foreign exchange (Table 3). A change in the supply led to a significant change in the demand for foreign exchange (Table 4).

An inspection of the time-series graph (figure 2) confirms these results. The supply of foreign exchange took an upward turn from 1986 when the Structural Adjustment Programme was introduced. This was matched by an increase in the demand for foreign exchange.

The increase in both may be partly accounted for by the depreciation of the Naira against the major (trading) currencies of the world, particularly the United States Dollar (figure 5). The dollar exchanged for ₦1.7323, nearly twice the rate at the 1985 pre-SAP exchange rate.

These results confirm ourobservation of the official foreign exchange market situation. After the introduction of the economic stabilization measures through the Economic Stabilization Act (1982) and the gradual recovery of the slump in the global oil market, government was able to rake in oil revenue from a low ₦7.8 billion (1982) to ₦19.03 billion (1987) and up to ₦41.33 billion (1989). Supply of foreign exchange also rose as shown in Table 1.

As observed, the demand always exceeds the supply of foreign exchange. And because of the wide premium between the official and parallel market rates all available foreign exchange in the offical market is taken up. On the introduction of the Structural Adjustment Programme, foreign exchange was commodized and traded on. The wide premium in the exchange rate between

the two markets appears to have encouraged speculative and round tripping practices.

But our finding does not support the belief of the Central Bank of Nigeria that the recourse to the deregulation of the exchange rate would stop roundtripping. (Central Bank of Nigeria Research Department Series 92/08)

Our finding does not also support the position of the Central Bank that the pressure on the official market would ease off by aligning the exchange rate of the official and parallel foreign exchange markets. Thus in 1991, the official exchange rate was aligned with the parallel market rate by further depreciating the naira. Unfortunately, the parallel market rate increased further and the demand pressure on the official market remained.

Our finding also does not support the claim of the Central Bank of Nigeria that the demand for foreign exchange does not relate to need and that the pressure is due to multiple applications by end users. Fresh evidence in favour of our finding is that demand relates to need. The evidence is given by the result of the installation of the pro-rata and priority foreign exchange allocation systems. Despite these the pressure remains unabated. Also the Federal Government budget (1994) requirement of tying all imports to FORM 'M' irrevocable letters of credit for amounts from ₦1,000.00 and above has been implemented. The demand pressure still mounts.

Unable to meet the demand, the Central Bank of Nigeria has frequently suspended operations of the official foreign exchange market and extended the fortnightly sessions to three - week sessions.

Outlawing the parallel (black) market and returing to a fixed exchange regime have not solved the foreign exchange problem. Pressure has been mounted by the banks and end users of foreign exchange particularly

non-prioritized sectors of the economy for the opening of a second window for foreign exchange transactions to enable them purchase foreign exchange.

3.2.2 Hypothesis Two:

We advanced that no significant relationship exists between the demand for foreign exchange and banks liquid funds.

The result of the analysis of the data, and testing the hypothesis, shows that there exists a relatiionship between the two variables given by Pearsons (r) of 0.415. But the relationship is not significant.

The finding does not support the claim by the Central Bank of Nigeria that the demand pressure on the official foreign exchange is caused by the excess liquidity in the banking system (CBN 1990:32). This claim has been the basis of the issuance of stabilization securities on banks to mop their 'excess liquidity'.

What baffles one is the existence of 'excess liquidity' in the face of the liquidity crisis sweeping through the banks. Banks have been mounting pressure on the Central Bank to release funds held in stabilization secutiries because they are unable to meet their dpositors' demands. In support of their employers, the junior staff of banks embarked on strike action in protest to the Central Bank of Nigeria to release the funds held in stabilization securities. In Lagos, banks rationed cash to depositors.

Really banks have maintained liquidity ratios in excess of the officially prescribed ratios. In 1986 commercial banks maintained 55.2% against the official ratio of 30%. In 1988 they maintained 45.5% against a prescribed 27.5%.

The central Bank defines liquidity ratio as the total specified liquid assets as a proportion of total current liabilities (savings, time and demand deposits). Liquid assets include cash and cheque deposits. Among the liquid assets were deposits made against purchase of foreign exchange by end users. Thus failure to separate this from total liquid assets appear to be excess idle assets available to banks to trade in foreign exchange.

An examination of the interactions among the independent variables in Table 5 reveals that bank liquid assets highly correlate with imports given by Pearsons (r) of 0.917. This appears to suggest that a major portion of the liquid assets (cash and bank balances) constituted deposits for purchase of foreign exchange.

There is reason to believe that banks traded in foreign exchange and practiced roundtripping by reselling officially purchased foreign exchange at premium to their clients who authorised them to bid on their behalf. Banks acted as agents for their clients.

But mopping of 'excess liquidity' based on exceeding prescribed liquidity ratios appears to have ended up in mopping deposits made against purchase of foreign exchange. Thus, in many instances, banks were not able to fund their Central Bank accounts to cover their bid requests and many end users were unable to obtain the foreign exchange they applied for; their funds got stuck in the banks.

Since the economy entered into crisis from 1982, banks' liquid assets have suffered deterioration in quality in terms of realizability. Loans and advances to industry have been worst-hit as industry performance declined in capacity utilization traced to their inability to obtain foreign exchange for importing raw materials and spare parts. Many

manufacturing companies closed down and others operated at very low capacity levels. There has therefore been massive and widespread industry default on loans obtained from banks.

Thus banks' apparently high liquidity ratios cannot be a good measure of the liquidity of the system without ascertaining the realizable portion. The computation of a quick acid ratio (acid test) would be a better measure of the liquidity of the banking system. This removes the unrealizable, classified or non-performing credits from the total current (liquid) assets before dividing with the total current liabilities.

Stabilization securities are low interest - bearing instruments. The interest rate in 1993 at the time bank savings deposits cost 21% was only a paltry 12%. In effect, banks were penalized for sourcing deposits. This is one basic reason banks challenge the rationality for the issuance of stabilization securities, calling it a rape on their deposits.

The overriding reasons for the issuance of stabilization securities are to arrest, stabilize, and even reduce the depreciation of the Naira, inflation and demand pressure on the official foreign exchange market. Our finding shows that the demand pressure still exists. The data (Tables 1 and figure 5) show that exchange rate has worsened right up to now despite pegging it at ₦21.9960 to U.S $1.00 in the 1994 Federal Government budget. The official rate remains pegged as it is in the budget but the unofficial (black) market rate has reached about ₦54.00 to U.S $1.00.

It is strongly believed that the pegging of the naira exchange rate has discouraged the inflow of foreign exchange from private sources, particularly proceeds from non-oil exports. Government's hopes of boosting the availability of foreign exchange in the official market appear to be unfulfilled. It is therefore believed that the availability of the resource

has even dwindled, creating a further supply gap and exercerbating the demand pressure.

The author has been handling a Form 'M' application for irrevocable letter of credit for the importation of gilded buttons from the United Kingdom since March 1994. Of the total requirment of £18,174-00 (₦599,742-00) only 2% has been allocated to the client as at August, 1994. The official market session was held last in about May and has been suspended since then. This appears to confirm the observations on the situation for the official foreign exchange market.

3.2.3 Hypothesis Three:

We hypothesized that the demand for foreign exchange has no significant relationship with imports.

This hypothesis was tested. We found that there was no significant relationship between the two variables. Thus the null hypothesis was accepted as stated.

This does not mean that foreign exchange was not used for imports. In fact the interaction between the supply of foreign exchange and imports (Table 5) shows that a strong relationship exists between them indicated by a Pearsons (r) of 0.669. The regression coefficient of determination (R-square) is 44.76%. That is, imports explain 44.76% of foreign exchange disbursements.

The lack of significant relationship between the demand for foreign exchange and imports appear to mean only that the volume of demand was out of tune with imports. The volume of demand is a good measure of the amount of pressure on the official foreign exchange market.

The findings support the observations on the foreign exchange market highlighted in the available literature: Structurally, the economy is monocultural, import-dependent, externally oriented, and susceptible to external shocks. Industry is import-substitutional and dependent on foreign exchange resources for importation of raw materials and spare parts. Thus the demand for foreign exchange is heavy but only so much can be obtained and used for imports.

The Structural Adjustment Programme was intended to correct this structural defoemity but the instruments such as the floating of foreign exchange rate (exchange deregulation) created more problems. Industry is still heavily dependent on foreign exchange but account for less than 10% of non-oil exports. When discussing economic development or the way forward for this beleagered economy, the starting point has been how to earn foreign exchange to import raw materials, parts, and other inputs. Some how development in Nigeria seems tied up with foreign exchange. For example, industry and agriculture have been prioritized for the foreign exchange allocation formular.

Deregulation of the exchange rate aimed at discouraging imports and reduce the demand for foreign exchange through relative prices of imports vis-a-vis locally produced goods ended up in fueling inflation for all items including items we do not produce locally but desperately needed for production.

Monetary policies rely on demand management of foreign exchange. For example, stabilization securities depend on forcible curtailment of demand for foreign exchange. Since demand relates to need, demand can only be reduced when need reduces. It appears that this can be achieved through the systematic reduction in the demand for foreign raw materials

by a purposeful commitment in sourcing of local raw materials and development of processing technology/capability.

3.2.4 Hypothesis Four:

The null hypotheis was that there is no significant relationship between the demand for foreign exchange and private capital outflow (capital flight).

This hypothesis was tested. We found that there is a relationship between the two variables indicated by Pearsons (r) of 0.045 but the relationship is not significant. Thus the hypothesis was accepted as stated.

In fact, because of the inadequacies of the official foreign exchange market, private capital outflow through the official market was very unlikely to be heavy. Thus the result of the analysis is as expected.

The parallel market provided easy outlet for funds hitherto blocked at a higher price. But many also feel the premium was afterall not as wide as imagined after considering the cost of delays in obtaining discretional bid allocations, elaborate documentation, exchange rate risks, and tipping bank operators in the process of purchasing foreign exchange through the banks from the official market.

Thus many who had urgent need for foreign exchange bought the same from the parallel market.

CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMMENDATIONS

4.1 Summary

The foreign exchange rate of Nigeria's currency was administratively determined within the framework of the Exchange Control Act (1962) and reinforced by the Economic Stabilization Act (1982).

The exchange rate was deregulated on the introduction of the Structural Adjustment Programme in 1986. The deregulation of the exchange rate was aimed at reducing the demand for foreign exchange through the discouragement of import-dependent industries, reduction of exported goods through relative prices, and increase in the supply of foreign exchange by promoting non-oil exports. All of this was to be mediated by a floating exchange rate system that depended for effectiveness on a tight monetary policy.

The main thrust of the monetary policy was the regulation of the liquidity in the banking system. The failure to achieve stability in the exchange rate and relief from the demand pressure on the official foreign exchange market were blamed on an 'excess liquidity' in the banking system.

Consequently public sector dposits were withdrawn from the banks into the Central Bank of Nigeria; collateralization of foreign currency for naira - denominated domestic loans, disallowed; liquidity and cash ratios for banks, raised; calculation of cash ratios expanded from only demand deposit to all deposits; and naira counterpart of arrears of external payment recalled to the Central Bank. The most pungent and contentious was the mopping of 'excess liquitity' in the banking system with stabilization securities.

We were sceptical that the obstacle to external, and domestic macro-economic stability was an 'excess liquidity' in the banking system. This motivated us to conduct this research to determine whether a cause-effect relationship exists between bank liquidity and the observed crisis indicators in the official foreign exchange market.

We surveyed the available literature and determined that imports and private capital outflow are ends to which foreign exchange is normally applied. These were added to the variables of supply for foreign exchange and consolidated bank liquid funds as independent variables likely to explain or predict the demand for foreign exchange (dependent variable).

A one-group pretest-postest quasi-experimental research design was developed to establish the cause - effect relationship. Four hypotheses were developed to predict the relationship between the demand for foreign exchange and each of the independent variables. Data were obtained, and analysed on the computer.

Our analysis revealed that there is a significant relationship between the demand for and the supply of foreign exchange. We also found that a change in the supply of foriegn exchange led to a significant change in the demand for foreign exchange.

But there is no significant relationship between the demand for foreign exchange and each of bank liquidity, imports, and private captal outflow. These results were true to our prediction.

These findings lead us to the following conclusions:

4.2 Conclusions

4.2.1 The demand for foreign exchange exceeds its supply and both have a significant positive relationship. A change in the supply of foreign exchange leads to a change in the demand for foreign exchange.

The volume of demand for foreign exchange provides a measure of the pressure on the official foreign exchange market. The demand pressure on the official foreign exchange market is inherent in the market itself.

4.2.2 The demand for foreign exchange has no significant relationship with bank liquid funds. In other words, the effect of bank liquidity on the exchange rate, and on the demand pressure on the official foreign exchange market is not significant; the effect is negligible.

Also a change in the liquidity position of banks does not lead to a significant change in the demand for foreign exchange in the official foreign exchange market.

Rather, the movement of the exchange rate was determined by the excess demand over the supply of foreign exchange, a situation that normally arises when demand expands but supply is fixed or nearly fixed. Considering the premium between the official and parallel market rates and the desperation of end users for foreign exchange to keep production going, the high exchange rate was as expected.

This explains the persistence of the depreciation of the naira and the numbing demand pressure on the official market despite the mopping of the 'excess liquidity' from the banking system. The depreciation of the exchange rate in the official market was arrested only by administrative fiat in the Federal Government budget of 1994 which fixed it at ₦21.9960 to U.S $1.00.

4.2.3 The demand for foreign exchange has no significant relationship with imports.

Since the demand for foreign exchange has no significant relationship with bank liquidity the lack of significant relationship between the demand for foreign exchange and imports cannot be inferred that foreign exchange obtained was not used on imports. The observed lack of relationship could only mean that the magnitude of demand by far exceeded the volume of exports.

We know that the foreign exchange ended up utilized by end users for the importation of vital materials and parts, and goods.

4.2.4 The demand for foreign exchange has no significant relationship with private capital outflow.

This finding/observation has to hold because the grossly inadequate funding of the official exchange market and the elaborate documentation often meant endless delays in obtaining needed foreign exchange and suffering exchange rate risks causing many in urgent need for foreign exchange to buy the same from the parallel market.

4.3 Recommendations:

Based on the above findings we recommend these policy measures:-

4.3.1 Foreign Exchange Policy

Foreign exchange resources management should take:

(i) a systematic demand reduction and

(ii) a systematic supply approach.

(a) (i) Systematic Demand Reduction Approach

This should aim at reducing the need for foreign exchange without necessarily reducing domestic production capability.

The demand for foreign exchange is a derived demand for imported materials, parts and finished goods. Producing these will automatically/simultaneously reduce the demand for foreign exchange to import them.

Demand reduction in foreign exchange can be achieved through local sourcing of raw materials, parts and enhancing processing capability. Government should offer incentives to industry for sourcing these locally and also provide the enabling environment for achieving this. The idea is not new but the need for determinate pursuit of this policy has become more compelling in the current foreign exchange crisis confronting the economy.

The Raw Materials Research and Development Council has been in operation since about 1983 but it seems we are more desparately dependent on foreign raw materials. It seems to indicate that the level of achievement is not commeasurate with the raw material requirements of industry. The Council should be strengthened and motivated and adequately equiped to conduct more research.

The approach suggested here is an improvement on the present forcible demand curtailment approach adopted by the monetary authorities which has created distress for the banking system, and frustration and uncertainty for end users of foreign exchange.

(ii) Systematic Supply Approach

The supply of foreign exchange is a function of export earnings and foreign investment income. The bulk of foreign exchange is obtained from exports and we are yet to fully tap the investment opportunities in our economy.

The stress here is placed on manufacturing industries as the hope for earning foreign exchange. To achieve this hope, existing industrial capacity has to be utilized.

The greatest handicap of industry now is obtaining raw materials and spare parts for production. The suggestion for a systematic reduction in the demand for foreign exchange made above apply here to alleviate the shortage of materials. Additionally agriculture should be developed in service of industry in the realization that the comparative advantage of developing countries is in manufactures; not in agriculture.

To overcome protectionist practices of the developed countries against our manufactures, we should create demand for our exports through bilateral trade agreements.

[b] Exchange rate policy should take a short run and long run perspective.

(i) In the short run, a dual exchange rate policy should be implemented: An official fixed rate for the importation of capital goods required to build industry. And a floating rate for finished goods import.

(ii) In the long run, a unified market-determined exchange rate policy should be implemented. The long run position is one in which the foreign exchange market will be adequately funded to largely accommodate demand for foreign exchange. This appears to be the only effective means to eliminate the illegal (black) market for foreign exchange derailing government's exchange rate policy.

The exchange rate will not be left entirely to be determined by the market. Rather we are suggesting that the monetary authorities intervene to fine-tune the supply of foreign exchange to maintain and/or achieve a desirable exchange rate for the overall benefit of the economy.

The approach we are suggesting will be an improvement on the one abandoned by government. The market will be funded adequately to enable the floating or market - determined exchange rate to be operated. It is not the idea of floating exchange rate that was new, or wrong and was abandoned. It was the prematurity in the adoption of the system that led to the exchange rate crisis, and was rejected.

.3.2 Liquidity Management Policy

[a] (i) Stabilization securities should be competitively priced with other debt - instruments to attract liquid banks voluntarily invest in them.

(ii) The stabilization securities should be structured along the lines of the kind of bank deposits (time, savings and demand deposits) from which funds are held. This will help in pricing the instrument and match the maturity of funds.

Currently the Central Bank debits banks when their liquidity ratios exceed the officially prescribed ratios. Banks say they do not know the basis of the debits.

(iii) We also suggest that the Central Bank should credit banks with the monthly interest on funds held in stabilization securities to enable the banks pay interest on deposits to their customers and meet transaction demand of depostitors.

[b] In computing the liquidity position of banks, the non-performing component of banks' current assets should be removed before dividing with current liabilities. This will enable the Central Bank determine the actual liquid position of banks. The banking system is ladden with a large non-performing and unrealizable credit portfolio that is causing distress for the system.

4.4 Future Research

This is a pilot study. We therefore recommend that it should be carried out after some years to see whether the results in this study will be replicated. A replication of these results will give a reliability better than a single study affirmed with statistical tests of significance.

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APPENDIX

COMPUTER PRINT-OUT (REPRODUCED)

	N	MEAN	MEDIAN	TRMEAN	STDEV	SEMEAN
DV	12	113666	105623	112162	19890	5742
IV1	12	23527	14014	20642	19707	5689
IV2	12	9856	4676	8676	9426	2719
IV3	12	19009	11349	15454	19556	5645
IV4	12	1784	973	1595	1868	539

	MIN	MAX	Q1	Q3
DV	91147	151248	97696	131262
IV1	8943	72958	10655	30252
IV2	2667	29442	2519	18751
IV3	4485	69083	6120	23405
IV4	319	5132	478	3704

The regression equation is

DV = 87094 + 1.19 IV1 - 2.70 IV2 + 0.630 IV3 + 7.33 IV4

Predictor	Coeff	Stdev	t-ratio
Constant	87094	5399	16.13
IV1	1.1943	0.1816	6.58
IV2	-2.696	1.675	-1.61
IV3	0.6299	0.7192	0.88
IV4	7.330	3.158	2.32

s = 7433 R-sq = 91.1% R-sq (adj) = 86.0%

Analysis of Variance

SOURCE	DF	SS	HS
Regression	4	3965067008	991266752
Error	7	38676920	55252732
Total	11	4351836160	

SOURCE	DF	SEQ SS
IV1	1	2798224128
IV2	1	374868832
IV3	1	534310048
IV4	1	297664096

Durbin-Watson statistic = 2.98

CORRELATION COEFFICIENTS

	DV	IV1	IV2	IV3
IV1	0.796			
IV2	0.415	0.760		
IV3	0.209	0.669	0.917	
IV4	0.536	0.245	0.325	0.045