SOME ECONOMIC CONSIDERATIONS FOR NIGERIAN CURRENCY DEVALUATION

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Abstract of Paper

Nigeria's foreign exchange reserves plummeted to an all time low in 1982. The trend since 1975 has been progressively downwords and if left uncorrected would deplete the nations foreign exchange resources in no distant future. It is argued in this paper that devaluation along with other fiscal and monetary measures would serve to enhance the external reserve position of the nation. The salutory impact of the 1973 Nigerian devaluation can be repeated to correct the worsening trend in the nations external asset position.

Some Economic Considerations for Nigerian Currency Devaluation

1. Introduction

Nigerian is basically a mono-product economy. Ninety percent of her export is made up of oil and only about 10% is made up of non oil products.[1] The pursuit of independent exchange rate policy has not been possible partly as a result since the economy depends excessively on international trade. (See table 1 for the composition of Nigeria's export trade)

Nigeria devalued her currency by 10% in 1973 for the first time in response to U. S. devaluation the same year of the same amount. Nigeria's foreign exchange reserves grew by 773.5% in 1974. Thus the impact of the devaluation in the preceding year was salutory in enhancing the foreign exchange asset position of the Nation (See Table II on Nigeria's foreign exchange). Many other factors contributed to the growth of Nigeria's foreign exchange in 1974 amongst which is the increased export of oil as a result of the 1973 Arab-Israeli war and the increased oil price negotiated by OPEC of which Nigeria is a member.

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[1] Federal Republic of Nigeria, *Third National Development Plan* 1975-80.

A cursory look on Table I would show the progressive rise of the oil sector in Nigeria's export trade. In 1966 it contributed 32.7% of Nigeria's export reaching its highest level of 93.6 % in 1976. Prior to this level, the non-oil sector, mainly agricultural raw materials dominated Nigerias export sector.

Table 1

NIGERIA'S EXPORTS : THE OIL AND NON-SECTORS 1966-1978

Year	Oil Sector (₦ Million)	%	Non-Oil Sector (₦ m.)	%	Total (₦ m)	%
1966	184.0	32.7	378.2	67.3	562.2	100
1967	144.2	29.8	339.4	70.2	483.6	100
1968	74.0	17.5	348.2	82.5	422.2	100
1969	261.8	41.2	374.0	58.8	635.8	100
1970	509.8	57.6	375.6	42.4	885.4	100
1971	951.8	73.4	345.6	26.6	1297.4	100
1972	1176.2	82.1	258.0	17.9	1432.2	100
1973	1893.5	83.1	384.9	16.9	2278.4	100
1974	5365.7	92.6	429.1	7.4	5794.8	100
1975	4563.1	92·6	362.4	7.4	4925.5	100
1976	6321.6	93.6	429.4	6.4	6751.1	100
1977	7072.8	92.7	557.9	7.3	7630.7	100
1978	5401.6	89.1	662.8	10.9	6064.4	100

Sources : Central Bank of Nigeria, *Annual Reports and Statements of Accounts and Economic and Statistical Review* (Central Planning Office, Lagos).

Also as shown in Table II, Nigeria's external reserves have had a checkered history. What we have is instability and fluctuations until 1974. Since then. there is a marked definite and progressive drop. If trend continues, our reserves would deplete in no distant future. The 1982 oi glut and the dimunition in our reserves is a valid case in point.

This has led to the current debates on the effectiveness of devaluation vis-a-vis import restriction measures in shoring up Nigeria's foreign exchange reserves. In April 1982, the Federal Government of Alhaji

Table II

NIGERIA'S EXTERNAL RESERVES 1970-1978

Year	Amount (₦ million)	Annual Rate of change
1970	160	66.7
1971	284	77.5
1972	284	10.6
1973	389	53.1
1974	3,398	773.5
1975	3,315	—2.5
1976	2,991	—9.8
1977	2,439	—18.5
1978	1,161	—52.3

Source: C. N. Isong, "Nigeria's External Finance", *Nigerian Journal of International Affairs*, Vol. 1, p. 51.

Shehu Shagari passed an Economic Stabilization Act through the parliament, this was a draconian measure intended to reduce substantially Nigeria's import of goods and services. Such measures although prohibited by the Articles of Association of the I. M. F. have been in vogue in developing countries as modes of accommodation to shortfalls in foreign exchange reserves. Apologists of such measures are afraid of stated consequences of devaluation. According to them, devaluation signifies a disaster, an admission that traditional means of accommodation have been exhausted.

This is not right. Nigeria devalued in 1973 without any attempts to explore and exhaust other options of accommodation open to her. Great Britain devalued in 1967. The U. S. has devalued in 1973 and France did same in 1969 followed by her 14 Francophone African countries. Devaluation thus should not be seen as an outlandish and terrible act, it is a permissible method of repegging the exchange value of a currency in the light of new supply demand reality. The International Monetary Fund (I. M. F.) allows countries to devalue in order to correct "fundamental disequilibrium" in their balance of payments.

Pros and Cons of Devaluation

It is argued that our trade position may not be improved. The effect of depreciation would be to worsen the terms of trade and that

adjustments to the altered international trade prices take time to materialise. Although changes in the terms of trade would appear adverse this is to lead towards enhancement of our exports and the reduction of imports in response to the relative price changes. According to Alfred Marshall and Abba Lerner (Marshall Lerner Condition),[2] devaluation would improve trade balance if the sum of price elasticities of demand of a country's imports and exports exceeds unity.

Subsequently the measurements of these elasticities give rise to an "elasticities pessimism" which pointed to the practical difficulties of attaining the requisite magnitude of elasticity that would make devaluation yield the required result. This pessimism is even more pertinent with developing countries with traditionally low demand elasticities for imports and weak supply response. This is not so for Nigeria where the demand elasticities for imports are high and the supply response is strong.

In the short run, it is further argued, prices of our primary export commodities including petroleum might have been predetermined in the world markets, so that exchange depreciation is unlikely to confer any more benefits in terms of increased receipts.

Even where prices are predetermined, the lower the prices in terms of currencies of importing countries, the more that is going to be exported by Nigeria. Unless the supply is fixed, which is not so. And given a high demand elasticity, the greater the demand, the greater the total revenue. So the nation's total receipts cannot be static unless demand elasticities are low.

It is also argued that owing to our growing need for imports, devaluation would have entailed higher import prices. Further that devaluation would add to domestic inflation. The high import prices would reduce demand for foreign goods and curtail our expenditure of foreign exchange to service a high import bill. Inflationary consequences of devaluation can be mitigated by the use of additional fiscal and monetary controls to mop up domestic liquidity.

(2) Recommendations and Conclusion

A recent study by Nigeria's Central Bank[3] shows that devaluation would enhance Nigerias balance of payments position if this is not

[2] C.C. Ozumba "Devaluation and Balance of payments in E C O W A S countries : A study of Nigria's Exchange Rate policy" Central Bank of Nigeria, *Economic and Financial Review* Vol 16, No. 1, 1978.

[3] *Ibid.*

done in isolation. Thus in combination with stringent monetary controls aimed at restricting the growth of domestic credit, devaluation will improve the balance of payments picture considerably.

Since interest rates in Nigeria are generally low everaging about 12%, which is below the average rate of inflation and as such real rates of interest are indeed negative, a step in the right direction should come from raising the interest rates to encourage savings. Further, the direction of trade should be changed away from mainly metropolitan countries i.e. Britain, France, U. S. to other countries of Europe and Asia where Nigeria can in pure barter terms exchange her oil for capital and technology, This may or may not need any foreign exchange to consumate. The composition of Nigeria's export trade should also be changed. A shift from a mono-product economy to a more diversified economy is suggested so that fluctuations in export earnings from one source can be mitigated by stability in others. The nation would thus benefit from the statistical law of large numbers by diversification. Taking a dynamic view of the economy agricultural products and manufactured goods would attain international price competitiveness with devaluation and the present composition of exports would change for the better. In conclusion, Nigeria should devalue the Naira currency by about 10% or more.[4]

[4] ₦ 1=1.12 grammes of gold

$ 1=0.63 grammes of gold

Therefore ₦ > $ by $1. 12—0. 63=0.43 units

Therefore % appreciation=37%. But maximum allowable rate of devaluation without consultations with I. M. F.=10%