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Exchange Rate Management in Nigeria: Historical Trends and Policy Insights

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ABSTRACT

The exchange rate is critical in any economy, especially where imports exceed exports. A depreciated local currency boosts export trade by making it cheaper in the international market and increasing foreign exchange inflow. However, it also makes imports expensive and depletes available foreign exchange. The study reviewed the exchange rate in Nigeria on a decade basis for a holistic overview of the rate over six decades. Nigeria's import trade is massive compared to the export trade. As a result, the demand for foreign currency is constantly rising, and due to insufficient supply, the exchange rate continually depreciates. Different exchange rate systems have been adopted to manage the rate, but none has yielded a desirable sustainable result. The pre-colonial and pre-structural adjustment programme (SAP) eras saw no significant concerns about the exchange rate, with the Naira being stronger than the US dollar, and the rate was fixed throughout. Since the introduction of SAP, different exchange rate systems like the Second-tier Foreign Exchange Market, Autonomous Foreign Exchange Market, Retail Dutch Auction System and Nigerian Autonomous Foreign Exchange Market have been used, yet the Naira has depreciated several times. There is a need to control the demand for foreign exchange, supervise parallel market activities, support export initiatives and monitor the repatriation of export proceeds.

Keywords: Exchange rate system; exchange rate, foreign exchange market, exchange rate depreciation, export, import.

INTRODUCTION

Nigeria, as a British colony before its independence in 1960, was tied to the British economy. There was bilateral trade between the two countries, and while Nigeria produced raw materials for the British, it served as a market for the British processed goods. This historical tie, shaped by colonialism, significantly impacted Nigeria's economy (Adewara, 2021). The country was free from exchange rate fluctuation because it adopted British Pounds as its legal tender. The foreign exchange system was stable, and the balance of payment was not at a disadvantage. Whenever the foreign receipt was higher than the foreign exchange expenditure, the surplus was added to the reserve to finance the trade deficit (Nwafor, 2017).

Nigeria has embraced different exchange rate regimes over the years; however, the different exchange rate system impacts the macroeconomic variables (Udochukwu & Chukwu, 2019). Before September 1986, the country adopted a fixed exchange rate system, which was stable since market forces did not determine it. However, in September 1986, the country adopted a flexible exchange rate system and used different variants. Naira was strong in the early eighties, even stronger than the United States Dollar, although it was argued to be overvalued (Iheanachor & Ozegbe, 2021).

Nigeria used the retail Dutch Auction System, wholesale Dutch Auction System, managed floating, free floating, and multiple exchange rate systems at different times. The different systems adopted at other times were to ensure rate stability, but none could stabilise the rate for the long term. The monetary authorities introduced various policies to manage the rate; however, the rate kept depreciating. With Nigerians' irreversible change in taste during the boom, the Central Bank of Nigeria (CBN) has been tackling the demand side of the foreign exchange market with minimal success. Other policies to boost the supply side were introduced to ameliorate the challenge. Contrary to expectation, the rate persistently depreciates.

Many scholars have studied the exchange rate regimes, exchange rate volatility, fluctuation, the macroeconomic variables and other factors responsible for the exchange rate's instability and its implications on the economy, with less focus on the historical trend that exposes the shortcomings of the various regimes. This gap spurred the study, which aims to provide a comprehensive overview of the major developments, policies, and milestones that have influenced the country's exchange rate regimes, which were introduced to manage the exchange rate from pre-independence. The review will offer insights into the efficacy of the different exchange rate policies by analysing the successes and shortcomings of the various exchange rate systems. It also sets to inform present and future policies and decisions, resulting in a more stable and efficient exchange rate management framework for Nigeria.

Nigerian Exchange Rate System: Pre-Independence

The exchange rate systems in each country differ; while some countries adopt fixed exchange rates, either hard-pegged or soft-pegged, with robust reserves to maintain this rate, others operate flexible exchange rates (Obadan, 2007). According to Tornell and Andres (2000), there is much indiscipline under a fixed exchange rate system; however, Crockett (1987) opined that a fixed exchange rate system availed much certainty regarding trade capital flow in the balance of payment (BOP). Rather than relying on market forces to decide the rate, the rate is administratively determined and supported by the foreign reserves, hence the need for a robust foreign reserve.

Nigeria was an agrarian economy that depended on cash crops for its foreign exchange until the discovery of crude oil at Oloibiri in 1956. This led to a shift from an agrarian to an oil-based economy, which profoundly impacted Nigeria's exchange rate management, altering the country's economic trajectory in an unprecedented and far-reaching way.

From 1916 to mid-1959, Nigeria operated a peg exchange rate system. The currency, the West African Pound, was pegged to the Sterling Pound (Alagidede & Ibrahim, 2016). Before establishing the CBN in 1958, Nigeria's foreign exchange management system lacked a clear framework. The proceeds of export trades were held in banks abroad, acting as the agents of the local exporters (Hashim & Meagher, 1999). There was no CBN, so the private sector owned the proceeds. However, with the establishment of the CBN in 1958, the need for a structured system became paramount. With unparalleled authority and responsibility, the CBN has played a pivotal role in shaping Nigeria's foreign exchange landscape. Its significant influence and power are evident in how it managed and regulated the country's foreign exchange market. By July 1, 1959, the CBN issued the first set of Nigerian banknotes, and the currency issued by the West Africa Currency Board was withdrawn from circulation.

Nigerian Exchange Rate System: 1961 - 1970

A fixed exchange rate system was adopted immediately after Nigerian political independence in 1960. A system that made the Nigerian currency exchange rate fixed administratively and responsive to changes in Great Britain Pounds and United States Dollars (Obadan, 2007). Nigeria's currency was pegged to GBP until 1967 (Ogiogio, 1996). The Nigerian Pound was equivalent to the Great Britain Pound; however, by 1967, the GBP was devalued. Consequently, Nigerian currency was pegged to United States Dollars up to 1970. The currency depended on the changes in the US Dollar; any impact on the US Dollar was reflected in the Nigerian currency.

The Exchange Control Act of 1962 was a significant policy introduced to increase foreign exchange receipts, reduce disbursement, improve the balance of payment position, and enhance foreign reserves (Ochei et al., 2016). This Act played a crucial and pivotal role in ensuring the stability of the foreign exchange market. The Act gave the monetary authorities the power to approve the application and utilisation of foreign exchange for the settlement of both visible and invisible trades. It also mandated the residents to submit all foreign exchange receipts to the monetary authorities. The responsibility of controlling the sources and application of foreign exchange in the country was vested in the minister of finance, who subsequently delegated the responsibility to CBN and authorized banks.

The residents were not permitted to hold foreign currency; they were mandated to submit all their inflows to

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theCBN through the authorized banks. The exporters were mandated to repatriate proceeds to CBN through the authorised banks within six months after shipment. The foreign exchange users, importers of visible and invisible trades, were to apply to CBN through the authorised banks subject to foreign exchange guidelines. Furthermore, some hotels were authorised to buy foreign exchange from foreigners, but such foreign exchange was sold to the CBN or the authorised banks, strictly adhering to guidelines (Anifowose, 1983). Some of these policies were too strict, like repatriating export proceeds to CBN, a major discouraging factor in boosting non-oil export trades.

The Nigerian Civil War in 1967 distorted the economy and created a substantial balance of payment problem. The drop in oil production adversely impacted foreign reserves (Uche, 2008) and caused a sudden need for strict exchange control measures. The Exchange Control Act of 1962 was re-enforced to allocate foreign exchange by CBN on a priority basis and settle trade obligations within ninety to one hundred and eighty days while advance payment before receipt of goods required CBN approval. The mandatory approval from the CBN hindered trade flows, creating an impediment to the smooth operation of businesses. As a result, it was evident that this policy would have a limited lifespan.

Anifowose (1983) summarised the salient facts of the Act as follows: the Act introduced an import licence on 274 items and reduced personal home remittance for a foreigner. The Act further enforced the suspension of remittance of rent by foreigners that had properties in Nigeria, suspension of payment of dividends, profit, and royalties, although partially lifted in 1969, technical and management fees while director fee was reduced to a maximum of ₦2,000 per annum and reduce travellers' allowance for journeys to Sterling areas countries only. These measures were to reduce the foreign exchange expenses, thereby reducing their adverse impact on the external reserves.

The decade was marked by two significant events: the enactment of the Exchange Control Act in 1962 and the outbreak of the Civil War in 1967. While the Act had the potential to achieve its intended objectives, the devastating impact of the Civil War on the economy ultimately undermined its effectiveness.

Nigerian Exchange Rate System: 1971 - 1980

The breakdown of the International Monetary Fund (IMF) par value system in December 1971 forced Nigeria to peg its currency to United States Dollars. By 1973, the Nigerian currency bore a new name: the Naira. The country's currency unit was changed from one Great Britain Pound to one Nigerian Naira, equivalent to ten Shillings. At the global level, major currencies adopted a generalised floating system (Moser, 1997), but Nigeria maintained its pegged exchange rate system; however, with the devaluation of US Dollar later in the year, the Naira was pegged again against Great Britain Pounds. It became apparent that pegging the Naira to a single currency was not sustainable as the Naira was subjected to the vagaries in the currency it was pegged to and the inevitable sympathy devaluation of the Naira in response to the other currency, which led to high inflation in the country (Obadan, 2006). By 1974, the system of pegging the Naira against a single currency was scrapped, and the Naira was pegged to GBP or USD, whichever was stronger.

The Middle East crisis and the subsequent surge in crude oil production led to an unprecedented boom in the foreign exchange market and increased public expenditure in the 1970s. This global event profoundly and seriously impacted Nigeria's economy, necessitating immediate foreign exchange management strategies to mitigate the effects and ensure stability (Pinto, 1987).

The foreign exchange earnings increased, positively impacting the foreign reserve, and there was an appreciable improvement in the balance of payment. The balance of payment was in surplus of ₦3,102.2 million in 1974 and ₦157.5 million in 1975, but by 1976, the balance of payment was in deficit of ₦339.9 million (Anifowose, 1983). This led to the re-introduction of exchange control measures like the Exchange Control Decree of 1977 (Oluike, 2020) to charge foreign exchange offenders to the tribunal and introduce a comprehensive import supervision scheme (CISS). Under the CISS, importers of more than ₦20,000 underwent pre-shipment inspections by foreign inspection agents to ascertain the quality and quantity of the products. The CISS was also to check under-invoicing that could result in tax evasion and over-invoicing resulting in round-tripping.

Other policies were introduced during this period to curtail the demand for foreign exchange. The mandatory deferred payment of import trade for a period of 90 to 180 days but later replaced by payment at the presentation of documents like attested invoice and bill of lading, the discontinuation of school fee remittance to Nigerian students without a permit from the Nigerian embassy, and exemption of raw materials and spare parts from pre-inspection provided approved user scheme was provided and the maintaining balances in the offshore banks for timely settlement of trade obligations (Ojo, 1990; Anifowose, 1983).

Prior to 1978, Nigeria held its external reserves in the Federal Reserve of New York, the United States, and the Bank of England. The Naira exchange rate was tied to United States Dollars and British Pounds in the international market. However, from 1978, the Naira exchange rate was based on Nigerian's trading partners' currencies; hence, the CBN adopted a weighted basket of currencies (US Dollars, Great British Pounds, Deutschmark, the Japanese Yen, French Franc, Swiss Franc, and Deutch Guilder). As a result, CBN monitored these seven currencies to determine the daily Naira exchange rate. Given this method of determining the value of the Naira, it was evident that the Naira was over-valued as the exchange rate in the black market was higher than the official market rate (Ike, 1989).

The oil recession of 1978 aggravated the challenge, and a rescue mission for Naira was inevitable. The policy of Naira appreciation was embarked upon in support of the import substitution industrialization policy. Import substitution is a process of reducing reliance on foreign goods by replacing foreign goods with locally produced goods to support local manufacturers and reduce the demand for foreign exchange to settle trade obligations (Onipede et al., 2023). In the 70s, policies to support import substitution were introduced, such as tariffs, subsidies, and indigenization (Oluikpe, 2020), and the results were apparent in the textile and brewery industries, even in automobiles like Peugeot Automobile of Nigeria, which had about 70% local content.

The import substitution policy faced high import costs of raw materials, plants and machinery, leading to high production costs for the manufacturer. Given the inadequate infrastructure and low investment, the policy was short-lived. In 1979, Nigeria adopted a pre-shipment inspection scheme to ensure the correct quality and quantity of imported goods to conserve the scarce foreign exchange. The pre-shipment inspection agents (PSIA) inspected the goods and issued import duty documents, later replaced by a clean inspection report (Kareem, 2004). The PSIA were Cotecna, Société Générale de Surveillance, Bureau Veritas, and Intertek, and the four covered different countries in terms of country of supply of goods.

This remarkable decade laid the groundwork for Nigeria's ongoing foreign exchange management crisis. Despite reinforced exchange control measures, the oil boom's far-reaching impact could not be reversed. The resulting economic upswing introduced Nigerians to a new standard of living, which, to this day, remains irreversible.

Nigerian Exchange Rate System: 1981 - 1990

The economic situation worsened drastically during this period (Omoruyi, 1990). By the end of June 1982, Nigeria's balance of payment was at a deficit of ₦1.58 million against a surplus of ₦53.1 million in the corresponding period in 1981. The country's merchandise trade account suffered the same fate. The account had ₦1.159 million by the end of June 1981; however, by the end of 1981, the account closed with a deficit of ₦1.502 million, although the deficit was reduced by the end of the first half of 1982. Consequently, the country's external assets holdings were ₦915.4 million by the end of the first half of 1982 against ₦5.77 million during the same period in the previous year, 1981 (Central Bank of Nigeria, 1982).

The collapse of international oil prices in 1982 created a big challenge in the Nigerian economy. The inflation rate rose, and the need for debt rescheduling became inevitable. By the first quarter of 1982, the foreign reserve could not pay for a month's import bill, and the monthly revenue consistently declined (Obi, 1984). By April 1982, the Economic Stabilization Act of 1982 and fiscal austerity measures were introduced to reduce expenses on imports and reduce the demand for foreign exchange. The Economic Stabilization Act introduced stringent import controls, including import restrictions on additional goods and services, increased customs tariffs, restrictions on international transactions, and maximum foreign exchange allocation by the central bank.

The fiscal austerity measures included suspension of capital expenditure, reduction in expenditure on public investment projects that were not priority, wage and salary freeze in the public sector, increase in petroleum product prices, utility tariffs, administrative and bank lending, restriction of state and local government foreign borrowings and limited bank credit to private sectors (CBN, 1982; Obi, 1984; Pinto, 1987). The measures had a temporary positive impact on the reserves; however, the new system fueled the activities of the parallel market operators. An illegal floating exchange rate co-existed with the official fixed exchange rate, worsening the situation of the exchange rate system.

In 1983, the correspondent banks refused to extend their trade loans valued at ₦12 billion, except Nigeria agreed to the terms of the IMF. Unfortunately, Nigeria has fully utilised its automatic borrowing facility in the IMF; hence, it was a tough decision for Nigeria to continue to enjoy the foreign bank's trade facilities without agreeing to the IMF's strict conditions, including devaluation, removal of subsidy, and trade liberalisation. To benefit from IMF relief, Nigeria was to comply with the conditions. The economic situation continued to deteriorate due to the adverse impact of the oil glut.

The exchange control acts were further enforced to reduce the country's propensity to demand imported goods, but the various policies were insufficient (Ike, 1989). The parallel market rate continued to depreciate until the third quarter of 1984 (Pinto, 1987). The fixed exchange rate system obviously could no longer be sustained as it was viewed that the Naira was overvalued, hence the need for a realistic market-determined rate. Furthermore, the burden of Nigeria's debt was huge, and there was a need to reschedule the debt obligation, including those of the London Club and Paris Club of bank creditors and Export Credit Agencies. Nigeria could afford 30% of its annual export earnings to service its debt, but the acceptable percentage by its creditors was 50%, which it could not afford; hence, the acceptance of IMF conditions became inevitable (Ojo, 1989).

By September 1986, the structural adjustment programme was introduced to deregulate the economy, eliminate public sector production inefficiency and ensure steady economic growth (CBN, 2003). The dual exchange rate system commenced. The second-tier foreign exchange market rate (SFEM) operated alongside the first-tier foreign exchange market. The first-tier foreign exchange market handled national transactions like debt servicing and external obligations, while the second-tier foreign exchange market catered to private transactions where market forces determined the rate (Obadan, 2007). However, the Federal Ministry of Finance released its allocative power to the CBN while maintaining the approval of public sector transactions.

The official rate was applied to external debt-service payments, official foreign capital inflows, and other federal government transactions. The SFEM was perceived to give Naira its true value as the rate will be determined by available foreign exchange and demand. An average of US$100 million was estimated for weekly allocation, of which 30% was dedicated to debt servicing, while 70% was available for auction (Ogiogio, 1996). This 70% was available for all transactions except external debt repayment and subscriptions to international organisations. SFEM was expected to discourage imports and encourage exports since imports cost more Naira vis a vis US$ while exports earned more Naria given the depreciated value of Naira. In addition, it was expected that SFEM would eliminate over-invoicing for import trade and under-invoicing for export trade, which led to the loss of ₦15 billion from 1979 -1983 (Ike, 1989).

This first auction was held on September 26, 1986, and different authorised dealer banks participated by bidding at different rates. CBN supplied US$50 million, the demand was US$71.77 million, and the successful bid price was US$1/NGN4.6406. Contrary to the fixed exchange rate of US$1/₦1.5535 on September 25, 1986. By October 2, 1986, another bidding was held with the same supply of US$50 million, but the demand was ₦77.1 million, and the successful bid price was US$1/₦5.6. The Naira depreciated in the second auction due to increased demand while the supply remained unchanged. The first two sessions adopted an average pricing system to determine the exchange rate. This method was jettisoned in the subsequent bids to adopt the marginal pricing method, a system of the highest bidder in descending order until the available foreign exchange is exhausted. This method of marginal bid rate replaced the average successful bid rate from the third bid session. In the third session, CBN increased the supply to US$75 million, and the demand dropped to US$75.525 million. The highest bid rate was US$1/₦5.3499, and the lowest was US$1/₦2.7052, but the marginal rate was US$1/₦3.4999. The fourth bidding session was not significantly different; the marginal rate was US$1/₦3.9101.

The appreciation of Naira in the third and fourth sessions was due to revised guidelines on bid rate and the maximum amount an authorised dealer can bid for. It was reduced from 10% to 5% of available foreign exchange for CBN, First Bank, Union Bank and UBA but 3% for other authorised dealers. The marginal rate was adopted as the market clearing rate and the exchange rate for Naira for the week. The benefit of this was that authorised dealers who quoted a higher rate than the marginal rate could get foreign exchange at a cheaper rate (Ahmed, 1987).

In pursuit of a better system and reduced propensity to import, the Retail Dutch Auction System (RDAS) was introduced in April 1987. Bidding was done fortnightly instead of weekly. During this time, individual bids were at the rates quoted by the end users. CBN supplied foreign exchange, and the exchange rate emerged as the marginal rate after the bids. Along the line, to attain an efficient system and remove subsidies accruing to First-tier participants, the First-tier and Second-tier Foreign Exchange markets merged to become a single market called Foreign Exchange Market (FEM) in July 1987. The merger increased demand because of the expansionary fiscal policy adopted. However, the foreign exchange supply could not match the demand, leading to high pressure on the exchange rate, which made the exchange rate depreciate significantly. The Autonomous Foreign Exchange Market (AFEM) was introduced in 1988 to allow banks to trade among themselves and encourage the repatriation of non-oil proceeds to augment the supply side (CBN, 2021). The exchange rate depreciated significantly, and rent-seeking activities grew sharply, increasing the demand for foreign exchange from CBN even though the official exchange rate was unrealistic.

By January 1989, the Inter-Bank Foreign Exchange Market (IFEM) had replaced AFEM due to massive demand for foreign exchange. The new system allowed banks to co-fund the market while CBN intervened as a participant. Contrary to the expected co-funding of the market by authorised dealers and CBN, CBN became a major source of foreign exchange. CBN supplied the authorised dealer banks with foreign exchange to meet the demand of their customers. Due to the high demand for foreign exchange and the limited supply from CBN, the gap between the black market and the official rate was very high. This led to high speculative activities, exchange rate arbitrageur, dual exchange rates, multiple bids and hoarding of foreign exchange. These factors further pushed Naira away from its real value in the official market and raised grave concerns as the exchange rate became very volatile (CBN, 2003). In finding solutions to new challenges, the Bureau de Change (BDC) was introduced in December 1990 to increase the official foreign exchange trading channels, address the needs of small foreign exchange users and replace the unofficial market. (CBN, 2021).

This decade was marked by numerous policy shifts, including the introduction of a flexible exchange rate regime accompanied by supporting policies. Although the exchange rate was market-driven, it continued to depreciate. The policies implemented during this period were largely stopgap measures, failing to address the underlying fundamental issues, which posed a significant challenge

Nigerian Exchange Rate System: 1991 - 2000

Upon the introduction of RDAS in 1990, there seemed to be a bit of sanity, but after a while, the norm returned, and the rate became very unstable. The Naira depreciated considerably, creating a high premium above the international benchmark rate of 5%. The exchange rate premiums were 20%, 35.5% and 79.2% for 1990, 1991 and 1992, respectively (CBN, 2003; 2021). This was overly high, created an avenue for unnecessary exchange rate gains, and increased the activities of the speculators. The behaviour called for attention to rescue the Naira. On March 5, 1992, CBN embarked on a rescue mission and completely deregulated Naira by introducing a floating exchange rate system.

On March 6, 1992, the rate moved from US$1/₦10.5564 to US$1/₦18.000. The Apex bank provided enough foreign exchange if the authorised dealer banks (ADB) offered adequate Naira. By the close of 1993, the rate averaged ₦21.9000 per United States Dollar, although this was pegged for the more significant part of the year (Momodu & Akani, 2016; Gary et al., 1997). This was a big drop compared to an average rate of ₦17.3 per US Dollar in 1992. Unfortunately, it was the beginning of more depreciation of the Naira; the demand side refused to abate, and the supply side could not match the pace of demand for Dollars. The margin between the official rate and the parallel market keeps rising. By the end of 1994, the exchange rate premium in the market was 350%. To curb this, CBN introduced a sectorial allocation of foreign exchange. Consequently, allocation was made to critical sectors/products, and some sectors or products were given priority. Unfortunately, all these measures could not help actualising the goals of reducing demand for foreign goods and increasing non-export proceeds and capital inflow.

In 1995, the Apex Bank reintroduced AFEM to allow participants in the foreign exchange market, including exporters in the non-oil sector, to adopt a market forces model for exchange rate determination (CBN, 2021). This encourages the inflow of non-export proceeds to boost the demand side. However, the rate was administratively fixed for public sector transactions at ₦21.9960. The system operated dual exchange rates during this period (Ojo, 1990). The CBN intervened in the market while the BDC was allowed to operate as a buyer and seller of traveller cheques. In addition, the Exchange Control Act of 1962 and the Enterprises Promotion Decree of 1989 were abolished, and non-oil exporters were allowed to sell their proceeds at the autonomous market rate.

These policies were retained mainly in 1995, 1996 and 1997. By 1998, the AFEM rate was ₦84.4 per US$, a 283.81% drop in Naira value, underscoring the urgency of the situation. The official fixed exchange rate for official transactions was subsidised compared with the AFEM rate, which led to round-tripping and other sharp practices. In January 1999, the official rate was eliminated, and the unitary AFEM rate was adopted as the exchange rate; however, by October 25, 1999, the market could not stand as the rate was no longer sustainable (CBN, 2021).

IFEM was reintroduced in October 1999 to address the exchange rate. The new system allowed many market participants, including oil companies, private companies, BDC and others, to trade in the foreign exchange market (Momodu & Akani, 2016). The CBN acted as the regulator, so the Apex Bank occasionally intervened, especially when the rate became unsatisfactory. This market was to eliminate the activities of speculators since there were many participants, and market forces were expected to regulate the rate. The Apex Bank introduced some foreign exchange controls to support the supply side of foreign exchange. Another significant action was the introduction of private institutions as foreign exchange outlets, like Travelex Global and Financial Services and American Express, to handle traveller cheques.

The exchange rate failed to show significant improvement compared to previous decades, instead continuing its downward trajectory. At first glance, the policies implemented during this period may seem ineffective. However, a closer examination reveals that a coordinated effort between monetary and fiscal authorities was necessary to address the challenge.

Nigerian Exchange Rate System: 2001 - 2010

Sadly, the solution expected from the reintroduced IFEM did not solve the humongous problem of depreciating Naira due to excess demand over supply and seemingly perennial unfavourable actions of the speculators and the arbitrageurs. By July 2002, the RDAS was reintroduced to rescue Naira. It was expected that RDAS would bring a bit of sanity to the foreign exchange market and reduce the activities of speculators and arbitrageurs.

The exchange rate was moderately stable during this period, and the premium was reduced to 18.2%, 13.5%, 9.8%, 5.5% and 8.0% in 2001, 2002, 2003, 2004 and 2005 respectively (CBN, 2021). In controlling the abuse in the foreign exchange market, open account as a method of payment was abolished effective January 2002. In March 2004, the authorised dealer banks were prohibited from engaging in free funds, a situation of foreign exchange sales for transactions without documents or ineligible transactions. By 2006, the auction system changed from retail to wholesale, so authorised dealers were expected to present their customers' bids for eligible transactions at a rate that applied to all the customers, unlike RDAS. This was to unify the various rates applicable in the market. Unfortunately, another set of problems, such as money laundering, came on board (Akpan, 2009).

In checkmating the foreign exchange malpractices and the loss of foreign exchange in payment of 1% FOB to the PSIA, the country re-introduced a destination inspection scheme on January 1, 2006 (Nwankwo, 2017). Cotecna Inspection Limited and Global Scan were the new Scanning and Risk Assessment Providers assigned to handle the destination inspection and issue a Risk Assessment Report (RAR). Other reforms include liberalising export proceeds; exporters have unfettered access to their funds. This was to encourage exporters and increase the supply side of foreign exchange. The utilisation of the trade finance facility was subject to CBN approval and was restricted to the financing of plant, machinery, and raw materials required by the manufacturing sector (CBN, 2021).

The wholesale Dutch Auction System (WDAS) continued from 2006 to July 10, 2009. The RDAS was introduced briefly before the system reverted to WDAS. The BDC reform introduced the classification of BDC into classes A and B and effective September 4, 2008, the maximum amount sold to BDC increased from US$200,000 to US$300,000 per market session (CBN, 2008). The net open position (NOP) for banks was adjusted on January 15, 2009, and CBN maintained a band of -/+3 for the exchange rate.

The monetary authorities and the CBN implemented various measures to mitigate exchange rate volatility during this period. However, similar to previous periods, the effectiveness of these policies was undermined by the persistent depreciation of the exchange rate.

Nigerian Exchange Rate System: 2011 - 2020

In curbing the challenges in the foreign exchange market and reducing foreign exchange demand, the CBN, on November 21, 2014, prohibited front-loading of foreign exchange purchases in RDAS and interbank. Sales were only made for fresh letters of credit and mature obligations (CBN, 2014). This also prevented panic purchases and speculative purchases. In February 2015, RDAS was suspended after its reintroduction and foreign exchange was sold in interbank while CBN intervened like any other participant in the market (CBN, 2021). This time, the problem was not majorly the ever-increasing demand but the declining oil prices, which directly affected the foreign reserves.

Other policy measures introduced were currency substitution policy to prevent the dollarization of the economy (CBN, 2015a). 42 items of import were classified as non-valid for foreign exchange, which meant that, though not prohibited, foreign exchange for payment of those items could not be sourced from the official market (CBN, 2015b). Foreign currency loans to non-Dollar generating businesses were outlawed (CBN, 2015c). This reduced the pressure in the official market as the obligors source foreign exchange in the parallel market to service the loans. By June 20, 2016, CBN announced the introduction of a flexible exchange rate system. The backlog of demand for foreign exchange was cleared, and the rate was around ₦220/US$1. The rate was perceived as too high, considering the interbank rate of ₦197/US$1 before the announcement.

In defending the Naira, an OTC Non-Deliverable Forward was introduced in September 2017 to hedge against foreign exchange risk. The challenge with this was that upon the OTC Future's maturity, many could not get the foreign exchange to liquidate their obligation; this caused a considerable default and reduced the flow of foreign direct investment and foreign portfolio investment. In meeting the demand for foreign exchange in the market, CBN intervened fortnightly through its retail secondary market intervention sales (RSMIS). However, the supply was inadequate to cater for the demand. Alongside, CBN supported RSMIS with wholesale allocation but was suspended in the first quarter of 2020. Sales were either spot or forward, even though the customers desired spot sales. The CBN decided on the tenor, but this primarily depended on the rate quoted by the customer. The forward sales spanned from 7 days to 180 days. The major challenge with this was that CBN debited Naira for the requests but would allocate part of the requests; however, the balance of the Naira would be returned a week later, whereas most of the foreign exchange was not delivered upon maturity of the forward. There was an imbalance in the exchange of values; Naira was taken on the transaction date, but foreign exchange will not be delivered months after the maturity of the bids.

Similarly, in April 2017, CBN intervened in the market weekly for small imports and invisible trade by small and medium enterprises (SMEs). The apex bank allocated US$20,000 per quarter per qualified SME customer (CBN, 2017). The CBN also introduced the investor and exporter window in April 2017 to ease sales of inflow of investment for issuance of electronic certificates of importation and to enable exporters to sell their proceeds at a market-determined rate. Furthermore, in June 2018, the country signed a Bilateral Currency Swap Agreement (BCSA) with China for a maximum of CNY15 billion for ₦720 billion for three years, subject to renewal. However, most imports from China were still settled in US$, hampering the objective of the swap.

In managing the crisis, multiple markets with different exchange rates emerged. There were five different ratesin the markets. Different rates were available for RSMIS with marginal rate as advised by the CBN, Wholesale rate quoted by ADBs, Small imports and Invisible trades at a rate determined by the CBN, Investors and Exporters (I&E) window at a market-driven rate, and IMTOs at the rate quoted by the CBN. Another policy introduced to curtail the huge demand for foreign exchange and control over invoicing was destination payment, which was introduced in August 2020. A price verification system accompanied this process to verify the prices of goods imported into the country. This was expected to reduce unscrupulous demands.

This decade saw the implementation of impressive policies aimed at stabilizing the exchange rate. Although expectations were high that the rate would finally stabilize, however, other macroeconomic variables were adversely affected, which in turn had significant effects on the exchange rate. This underscored the importance of a holistic approach, demonstrating that managing the exchange rate cannot be done in isolation, it requires careful monitoring of all critical macroeconomic variables.

Nigerian Exchange Rate System: 2021 – Date

In furtherance of CBN's actions to stabilise the exchange rate, in March 2021, CBN introduced the Naira-4-Dollar scheme. By this scheme, the CBN paid ₦5 through the commercial banks for every US$1 received through CBN-licensed IMTOs. This was to encourage diaspora remittances to augment the supply of foreign exchange in the country. Likewise, in February 2022, CBN introduced the Race-To- ₦200 billion in 3-5 years (RT200) programme to drive export trade. The programme incentivised non-oil exporters by paying ₦65 for US$1 repatriated and sold in I&E to ADB for third-party transactions and ₦35 for US$1 repatriated and sold in I&E for own use but strictly for eligible transactions.

CBN was under pressure to unify the multiple exchange rates, and by June 14, 2023, the CBN announced a free-floating exchange rate system and all the other rates were closed for a single market – NAFEM. Upon the unification of all rates and the emergence of NAFEM, approximately US$7 billion in forward sales matured, which CBN had to pay, hence the tension in the system. Many correspondent banks were worried about default as many had trade lines extended to the commercial bank awaiting payment from the Forward sales. To avert a loss of confidence in the system, the CBN had to review the outstanding Forward. Upon review, CBN classified some of the Forwards as invalid Forward and paid part while a substantial sum remained unpaid even though the Naira had been taken from the bid date. This non-payment led to a severe default, which created panic in the system.

Upon resumption in office by President Bola Ahmed Tinubu, he announced the removal of subsidies and unification of rates. This led to rapid depreciation. Thirty days after the announcement, the rate depreciated from ₦461.60/US$1 on May 30, 2023, to ₦770.88/US$1 on June 30, 2023. The rate has consistently depreciated and is now at four digits to a United States Dollar. The Apex Bank introduced other policies to arrest the depreciation of Naira. In October 2023, the 42 items of imports declared non-valid for foreign exchange were restored; as a result, foreign exchange for those items can be sourced from any of the official markets.

CBN introduced different reforms, including removing the cap on the spread of foreign exchange transactions, introducing the willing buyer and willing seller's model, and modifying channels for a payout of PTA and BTA to electronic channels only. This is to curb demand, especially among those who buy PTA/BTA but do not travel or do not need up to the amount purchased. Aside from this, CBN also introduced cash-pooling to international oil companies to support the supply of foreign exchange rather than moving the whole fund to the parent company. Other reforms were abolishing foreign currency-denominated collateral for Naira loans and reversing the Prive Verification System effective July 1, 2024. The policy required 50% cash pooling while the remaining 50% may be repatriated 90 days after receipt of the export proceeds.

The Apex Bank also introduced a new bidding system, the Electronic Foreign Exchange Matching System (EFEMS), which commenced on December 2, 2024. This system requires all ADBs to conduct all foreign exchange transactions on the platform, and it is expected to enhance governance and transparency.

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Table I Summary of the Nigerian exchange rate system from 1959 to Oct 2024

Date	Policy	Regime
1959 - 1967	Exchange rate parity with the British Pounds	Fixed
1962	Exchange Rate Control Act (only a single foreign exchange market)	Fixed
1967	Naira pegged to United States Dollars (USD)	Fixed
1970	Naira pegged to Great Britain Pound (GBP)	Fixed
1971	Naira was pegged against a basket of currencies, which included the Deutsche mark, the Swiss Franc, the French franc, the Dutch guilder, the Japanese yen, and the Canadian dollar.	Fixed
1978	Naira pegged to a basket of twelve currencies, adopting an import-weighted approach.	Fixed
June 1986	Introduction of SAP: Exchange rate liberalised	Flexible
Post June 1986	First Tier & Second Tier foreign exchange markets	Flexible
April 1987	Retail Dutch Auction System introduced	Flexible
July 1987	First Tier & Second Tier foreign exchange markets merged, and Foreign Exchange Market (FEM) was introduced.	Flexible
1988	Autonomous Foreign Exchange Market (AFEM)	Flexible
January 1989	Inter Bank Foreign Exchange Market replaced AFEM	Flexible
1989	Bureau de Change introduced	Flexible
December 1990	Reintroduction of the Retail Dutch Auction system	Flexible
1992	Naira left to float	Flexible
The exchange	Exchange rate officially fixed	Fixed
1995	Guided deregulation	Flexible
January 1999	Fixed official rate abolished	Flexible
October 1999	Interbank Foreign Exchange Market was introduced, and AFEM replaced	Flexible
July 2002.	Reintroduction of the Retail Dutch Auction system	Flexible
February 2006	Introduction of Wholesale Dutch Auction System (WDAS)	Flexible
January 2009	Reintroduction of the Retail Dutch Auction System	Flexible
July 2009	Wholesale Dutch Auction System reintroduced	Flexible
Sep. 2013.	WDAS was suspended, and RDAS introduced	Flexible
February 2015	RDAS abolished	Flexible
June 2016	IFEM with CBN intervention:	Flexible
	Retail Secondary Markets Intervention Sales (RSMIS)	
	Invisible Window (Travel allowance, educational and medical expenses)	
	Small and Medium Enterprises (SME) Window	
	Investor & Exporter (I&E) Window	
2017	NAFEX Fixing Market (I&E Window)	Flexible
	IFEM	
2023	Free-floating exchange rate system (NAFEM)	Flexible

Source: Various CBN circulars

Table i depicts the various exchange rate systems adopted since the country embraced SAP. The country has used different variants of flexible exchange rate systems, from SFEM to AFEM. The Interbank was adopted at a time. Likewise, the Autonomous market was used along the line. The WDAS and RDAS were also used at different times. Managed floating was introduced in 2016, bringing in the era of multiple exchange rates, unified with the introduction of the Nigeria Foreign Exchange Market (NAFEM) in 2023. These systems responded to various challenges in foreign exchange markets at different times. Historically, no particular exchange rate

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system has been adjudged as the best, but each has addressed a particular challenge. As another challenge arose, another system was introduced to curtail the problem. However, as the systems were changed, the rate depreciated further. This showed that the change in the exchange rate system is merely a temporary measure, but the fundamentals have not been addressed to get the true value of the Naira. On the other hand, the system may be right. However, as the demand for foreign exchange continued to rise and the supply could not match the demand, the rate continued to depreciate, hence the need to continue to support the growth of exports.

A snapshot of the supply side versus demand side of the foreign exchange in Nigeria

The various sources of foreign exchange continued to thin out as the rate depreciated. As the supply of foreign exchange from these sources is reduced, the pressure on the exchange rate increases since demand keeps growing

Table ii

Investment Type	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Foreign Direct Investment	2,277.04	1,446.62	1,044.02	981.75	1,194.67	934.34	1,027.68	698.78	468.08	337.38
Equity	2,264.01	1,442.41	1,043.15	979.44	1,189.03	922.24	1,024.73	692.58	462.91	337.33
Other Capital	13.03	4.21	0.88	2.32	5.64	12.10	2.95	6.20	5.16	0.05
Portfolio Investment	14,917.17	6,005.43	1,812.88	7,329.06	11,802.27	16,365.46	5,137.20	3,385.59	2,442.24	1,153.00
Equity	11,448.16	4,657.55	859.06	3,637.31	2,362.73	1,893.19	755.12	206.54	56.57	250.03
Bonds	2,443.99	776.28	395.90	482.84	966.82	1,022.39	231.22	564.11	980.34	474.08
Money market instruments	1,025.02	571.59	557.92	3,208.90	8,472.72	13,449.88	4,150.86	2,614.95	1,405.34	428.90
Other Investment	3,556.54	2,190.97	2,267.24	3,917.75	3,815.53	6,690.25	3,491.25	2,616.14	2,418.56	2,375.61
Trade credits	22.03	-	0.16	10.00	6.92	0.11	0.05	2.05	3.01	-
Loans	1,414.33	1,655.28	2,240.11	3,164.63	3,522.83	5,078.78	2,555.77	2,378.51	2,311.23	2,307.81
Currency deposits	-	8.10	0.03	3.52	1.03	2.96	0.82	6.60	9.32	1.91
Other claims	2,120.18	527.59	26.93	739.60	284.75	1,608.40	934.62	228.99	95.00	65.85
TOTAL	20,750.76	9,643.00	5,124.14	12,228.57	16,812.47	23,990.05	9,656.13	6,700.51	5,328.88	3,509.99

Source: NBS

Table ii shows a clip of capital inflow into the country from 2014 to 2023. Capital importation continued to dwindle. In 2014, the total capital importation was US$20.7 billion; however, by 2023, it had dropped to US$3.9 billion. By implication, the shortage of foreign exchange translated to Naira depreciation as demand continued to rise.

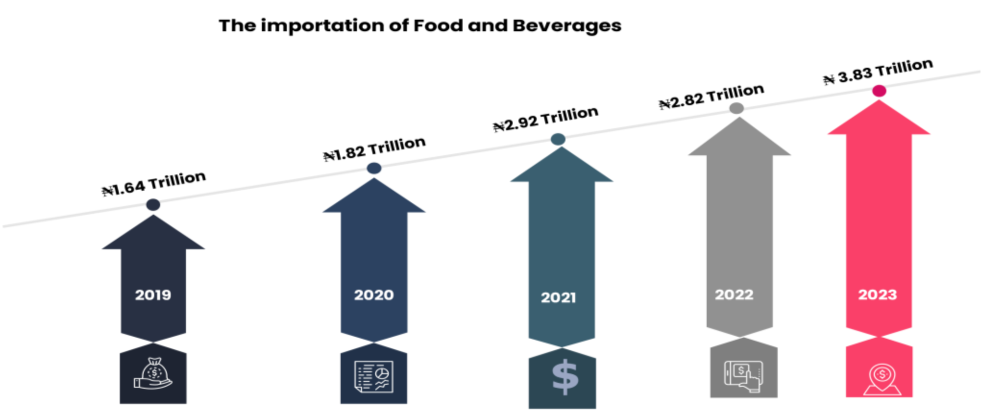

Figure i ***Sources*****: NBS**

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From Figure i, the demand for food and beverages rose, eliciting the need for more foreign exchange, significantly impacting the exchange rate. In 2019, the country imported food and beverages worth ₦1.64 trillion; the demand consistently rose, and by 2023, the importation had risen to ₦3.83 trillion, a 133.54% increase. The consistent increase in the demand for foreign exchange annually for importing local substitutes is a major bane to the economy. The foreign exchange expended on some items can be conserved, although the operating environment to support a shift from imported goods to local substitutes may not be conducive to growth. Infrastructure like power, good road network, security, communication, and others may be unavailable or inadequate; consequently, focusing on manufacturing local substitutes may be jettisoned for imported items.

Figure ii depicts the massive gap between export and import trade in the textile industry. While the country expended scarce foreign exchange on the importation of textiles, its corresponding exports are meagre, hence the huge gap. The textile industry earned little foreign exchange but spent a lot of it. Consequently, the sector demands more foreign exchange to cover the gap, thereby adding to the pressure on the foreign exchange market. The taste for Nigerians is one of the major challenges of foreign exchange management in Nigeria; Nigerians desire more foreign goods even when there are local substitutes. This unchecked taste that started during the oil boom in the 1970s has made the Naira depreciate significantly.

Figure ii Source: NBS

The impact of Naira depreciation is significant on the economy. The depreciation contributes to rising inflation, especially food inflation. As the cost of imported items rises, the local cost of the goods rises. CBN tries to reduce inflation by mopping up excess cash through open market operations and an increased liquidity ratio. The apex bank also mops up cash to reduce the activities of speculators. It is believed that excess cash in the system can fuel the actions of the speculators that take positions in United States Dollars. The monetary authorities also increase interest rates to attract investors and encourage savings. However, these measures are short-lived as the instability of the rate and scarcity of foreign exchange discourage investors.

In addition, the corresponding impact of interest rates on loans is counterproductive. The borrowers get loans at high interest rates, leading to a high cost of production for the manufacturers. Even agricultural loans are obtained at high financing costs with attendant adverse economic impacts (Femi-Olagundoye et al., 2024). The financial institutions also face the challenge of non-performing loans, forcing them to make provisions for the loans as the regulators demand. Even though CBN introduced a deposit ratio of sixty-five per cent with stiff penalties for non-compliance, many banks cannot meet this requirement, considering the fear of non-performing loans. An easy option for banks is to dollarise their balance sheets by taking deposits in foreign exchange that do not attract statutory cash reserved ratio, yet this is an interim solution. The banks cannot lend the Dollar deposit to non-dollar receivable borrowers. Consequently, the deficit sectors may not have full advantage of these deposits.

CONCLUSION AND RECOMMENDATION

The exchange rate has never been stable since the introduction of the flexible exchange rate system in September 1986. The rate has depreciated several times, from a single digit in September 1986 to four in 2024. The monetary authorities have used different policies to manage the exchange rate, but the impacts were always temporary, even when the policies worked. Within a short while, the rate will depreciate. The demand for foreign exchange is high because foreign exchange is needed for various purposes such as import settlement, speculative activities, arbitrageur, store of wealth, and many others. Consequently, the demand for foreign exchange is not for productive activities alone but for other purposes. This, therefore, continued to increase the demand side in contrast to the supply side, which consists of export proceeds, foreign direct investments, foreign debt, grants, royalties, home remittances, and aids. However, the supply is perpetually lower than the demand. As the supply side is short compared with the demand side, the exchange rate continues to depreciate, adversely impacting the economy. In pursuit of a solution, various exchange rate systems have been adopted in the past, but there have not been sustainable, successful results. The commonest among these systems is the Retail Dutch Auction System, but it has not addressed the depreciation of the Naira.

The exchange rate management strategy should priorities measures that continually enhance the supply of foreign exchange while implementing policies to curb demand. In managing the demand for foreign exchange, there is a need to reduce the taste of foreign goods. Local industries should be supported in producing substitutes for foreign goods. The textile, food and beverage industries and similar industries should be supported in producing local substitutes rather than importing and repackaging. This will conserve the foreign exchange for other productive uses. There are colonial ideologies that should be discontinued. There is no justification for adopting European suits as corporate wear for offices. The Nigerian fabrics can be designed to fit the same purpose, thereby conserving our foreign exchange and creating jobs.

The emphasis on redirection of focus from crude oil to non-oil export should continue. Non-oil exporters should be given adequate support for export expansion, and policies to track the repatriation of proceeds should be enforced. The activities of speculators and arbitrageurs should be checked, and foreign exchange purchases should be for productive reasons. Even though the parallel market is not recognised by CBN yet, it significantly impacts on the exchange rate. Therefore, monetary authorities should acknowledge the market and put policies in place to check the activities of the parallel market. Old foreign exchange regulations should be reviewed, and the relevant circulars based on the market dynamics should be suspended. Current issues have often overtaken circulars, yet banks are constrained because circulars are not withdrawn. As a result, foreign exchange users restricted by such old circulars from accessing foreign exchange in the official market are forced to patronise the parallel market.

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