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DEVALUATION OF NIGERIAN NAIRA: BANE OR PANACEA?

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Abstract

This work attempted a balance sheet of devaluation with a view to determining its desirability or otherwise owing to the raging debates over it. It is equally intended to assist government and policy makers alike of what line action(s) to take when there is need for macroeconomic policy to address urgent national issue. This paper relied on secondary source of data in a quantitative way. The paper acknowledged that devaluation is not peculiarly Nigerian, however the findings revealed that it does more harm than good as far as Nigeria is concerned. It consequently concluded that devaluation should not be seen as last resort each time there is global financial problem. The work made some policy recommendations.

Key words: Devaluation, Democracy, Macro-Economy, Citizenry, Government, Nigeria.

Introduction

The emergence of modern states globally and particularly in Africa in the 70s till now which is informed by the democratic wave in the continent confers enormous responsibilities on states irrespective of clime. It is acknowledged that Nigeria, like some other nations is mono-cultural and oil driven and as such not immured from the global crisis as the country is currently caught in the web of exchange rate. It is in a bid to grapple with this reality that Nigeria sees devaluation as the most probable solution each time she is in a financial quagmire. In the words of Adigwe (2013), the role of exchange rate in the economic performance of both developed and developing economies such as Nigeria constitutes one of the greatest macroeconomic policy debates. There is increasing argument among economists and policy makers that while stability in exchange rate promotes growth and improves standard of living, misaligned exchange rate hinders export growth and generates macroeconomic instability (Adigwe, 2013).

Devaluation of currency is a macro-economic fiscal policy that bothers on deliberate reduction in the value of home currency with the aim of maximizing gain in trade able items (Aiya, 2014). Scholarly work especially of African extraction has a bias for the fact that devaluation is an instrument being employed by the International Monetary Fund (IMF) and World Bank for fiscal equalization and stability, especially in the sub Sahara Africa as a result of high level of indebtedness to these financial institutions. In the opinion of Aiya (2014), devaluation of currency became popular in Nigeria when Babangida led Administration in 1986 instituted the Structural Adjustment Programme as a policy designed to achieve a realistic exchange rate for the naira that was over-valued. The fall-out of this policy made life difficult for average Nigerian. This is well summed up by Todaro (1982) that "this was unhealthy for economic growth and development of the nation since valued currency further worsen the balance of payment problem.

However, Osaghae's Cripple Giant, is an historical exploration of the genesis of this problem, which he traced to colonialism and imperialism. The above equally finds fulfillment in Rodney's "How Europe Underdeveloped Africa". The raging debate over the desirability or otherwise of devaluation in Nigeria makes this work relevant.

Methodology

The methodology framework for this study is essentially secondary source of data. Existing work in textbooks, journals, internet, etc were relied on. It engaged in descriptive as well as quantitative style.

Conceptual and Theoretical Framework

Devaluation, like any other concept is a victim of definitional pluralism. Hence, the need for concept clarification owing to fluidity and manifold meanings attached to them. This becomes essential to escape from Weldon (1981) that they can generate unsolvable debates about their meaning and application. Devaluation is a reduction in the value of a currency with respect to other monetary units. In common modern usage, it specifically implies an official lowering of the value of a county's currency within a fixed exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency (www.en.m.wikipedia.org/devaluation)

Historically, devaluation is most often used in situations where a currency has a defined value relative to the baseline. Early currencies were typically coins struck from gold or silver by an issuing authority which certified the weight and purity of the precious metals. (www.taxfreegold.co.uk). A government in need of money and short on precious metal might abruptly lower the weight or purity of the coins without announcing this, or else decree that the new coins had equal value to the old, thus devaluing the currency. This gave rise to Copernicus-Gresham's law, which stated that "bad money drives out good", i.e, if pure gold coins and false coins are decreed to have equal value, people will use the false coins for currency and hide the good coins or melt them down into gold (www.taxfreegold.co.uk).

In the opinion of Todaro (1982), currency devaluation is when a country's currency or more strictly depreciated when the official rate at which its Central Bank is prepared to exchange the local currency for dollar is increased. Subscribing to the debate, Campbell (2004) sees currency devaluation as a deliberate downward adjustment in the official exchange rate established by a government against specified standard or another currency.

Traditionally, there are three main approaches to devaluation or currency depreciation: the elasticity approach, the absorption approach and the monetary approach. (www.ukessays.com). According to the elasticity framework, devaluation improves a country's balance of trade when the Marshall-Lerner condition is satisfied, i.e, when the sum of the total import demand elasticity of the two trading partners exceeds unity. In the absorption methodology however, the elasticity do not matter, and the trade balance improves only if the nation's Gross Domestic Product (GDP) increases faster than domestic spending. According to the monetary approach to the exchange rate, a devaluation or depreciation decreases the real supply of money, resulting in an excess demand for money. (www.ukessays.com).

Theoretical Framework

The work is anchored on the theoretical framework of dependency theory. It was developed in the late 1950s by Raul Prebisch. Inspite the raging debates among liberal reformers (Prebisch), the Marxists

(Andre Gunder Frank), and the World Systems Theorists (Wallerstein) on the meaning of dependency as a theory, certain core propositions which underlie do exist. (www.en.m.wikipedia.org/dependency) Dependency can be defined as an explanation of the influences – political, economic, and cultural or national development policy (Osvaldo, 1969).

Put differently, dependency theory is the notion that resources flow from a "periphery" of poor and underdeveloped states to a "core" of wealthy states, enriching the latter at the expense of the former. It is a central contention of dependency theory that poor states are impoverished and rich ones enriched by the way poor states are integrated into the "world system" (www.en.m.wikipedia.org/dependency) . It arose as a reaction to modernization theory, an earlier theory of development which held that all societies progress through similar stages of development, that today's underdeveloped areas are thus in a similar situation to that of today's developed areas at some time in the past, and that therefore the task in helping the underdeveloped areas out of poverty is to accelerate them along this supposed common path of development, by various means such as investment, technology transfers, and closer integration into the World Market. (www.en.m.wikipedia.org/dependency).

The premises of dependency theory are that:

1. Poor nations provide natural resources, cheap labour, a destination for obsolete technology, and markets for developed nations, without which the latter could not have the standard of living they enjoy.
2. Wealthy nations actively perpetuate a state of dependence by various means. This influence may be multifaceted, involving economics, media control, politics, banking and finance, education, culture, and sport (www.en.m.wikipedia.org/dependency).

The theory suffers some pitfalls such as domestic opportunity costs. Subsidies on domestic industries come out of state coffers and therefore represent money not spent in other ways, like development of domestic infrastructure or need-based social welfare programmes (www.en.m.wikipedia.org/devaluation)

It is important here to stress that the genesis of the present predicament is inseparable from colonialism which facilitated the country's incorporation into the Western economic system. In the words of Sharmila (www.Infochangeindia.org) , poverty in the Third World is not 'traditional' or accidental. It is a necessary companion to the richness of the developed world. The manipulation of Nigeria's economy by the International Monetary Fund (IMF) and other global bodies are just extension of colonialism known as neo-colonialsm. The conditionalities attached to borrowing as well as devaluation are being dictated by IMF and others. To pretend that they are interested in Nigeria's welfare is a ruse. The above makes dependency theory the most appropriate to do justice to the theme under examination.

Justifications for Currency Devaluation

Almost all countries of the World have devalued their currencies to achieve certain economic objectives at one time or the other. Currency devaluation is linked to a country's export performance. Immediately after a country devalues its currency, the volume of its imports and exports may remain largely unchanged in part because existing trade contracts have to be honoured. Over the longer term, a devalued exchange rate can have the desired effect of improving a county's current account balance (www.aii.unimelb.edu.au). Domestic consumers may switch their expenditure to domestic products and away from expensive imported goods and services, assuming equivalent domestic alternatives exist. Equally, many foreign consumers may switch to purchasing the products being exported into their country, which are now cheaper in the foreign currency, instead of their own domestically produced goods and services. This provides the motivation for devaluation (www.aii.unimelb.edu.au).

Also, in contrast to the popular assumption that devaluation does all harm and no good, devaluation will make exporters of non-oil export products have more monetary value for their products while also bringing more dollars to the Nigerian economy. The current exchange rate condition offers some advantages to industries with high local value addition as it makes them more competitive than their foreign or import dependent counterparts. (www.sweetcrudereports.com)

In the opinion of Emmanuel (www.dailyindependentnig.com), the policy would boost agriculture production and local goods manufacturing and reduce dependence on imported goods. He noted that it was what was expected given the prevailing situation in the global oil market which has led to reduction in the price of crude oil per barrel. Similar argument is advanced by (www.officemanager.com.ng) by lauding the initiative as a bailout for the struggling economy which depends so heavily on crude oil exportation and massive importation of finished products, saying it may help in correcting the trade imbalance in the long run.

In another vein, Ernest (www.proshareng.com), said the objectives of exchange rate policy in Nigeria are to ensure balance of payment viability, maintain a stable exchange rate for the naira, ensuring external balance and the overall goal of macroeconomic stability and lastly, to reduce the gap between the official and parallel market, and prevent disequilibrium in the forex market.

Criticisms Levelled Against Devaluation.

A lot of reasons have been put forward as to why devaluation is not desirable. Some of the reasons will be examined under this segment. First, the most obvious impact of currency devaluation is an increase in the cost of importing raw materials and finished goods. This is even more critical as Nigeria is an import dependent country (https//www.pwc.com/…conducting). Many raw materials and consumers goods cannot easily be sourced locally and therefore need to be imported, resulting in higher prices which are passed on to consumers. (http//www.pwc.com…conducting). The irony of it that the nation's productive and manufacturing capacity is very low to cater for the needed raw materials.

Furthermore, it must be emphasized that the increase in Monetary Policy Rate (MPR) will take its toils on the real sector. The cost of loanable funds would have risen, as a direct consequence of the rise in the base lending rate.(www.nationonlineng.net). The development will be counterproductive, and against the thrust of government's touted plan to create jobs. Hence, there is an indirect correlation between increased interest rate and job creation (www.thenationonlineng.net).

Devaluation jump-starts and stalls industrial diversification more than it hurts agricultural export development. Devaluation also undermines the banks and consequently domestic ownership of privatized assets and performance of the rest of the real economy. Devaluation further hurts firms in trading as well as poor farmers and the urban poor. (www.archive.unu.edu/africa).

One other area where devaluation is being dismissed is regarding Foreign Direct Investment, (FDI). The nation's democratic consolidation is expected to create conducive environment for businesses to thrive to enhance economic growth. However, devaluation may dampen investors' confidence in the country's economy and hurt the country's ability to secure foreign investment (www.123helpme.com/devaluation).

Historical evidences and performance criteria are not supportive of devaluation as far as Nigeria is concerned. It has been a policy of last resort each time it is adopted. The devaluation of the naira will lead to a chain of reactions, many of which may not have the intended results. For a largely monolithic-economy, one that largely depends on oil, the expectation that a devalued naira will drive export of local products, which do not exist in the required volume for now, will create additional burden on the populace, the reason being that the cost of consumables, across the board, will escalate.(www.thenationonlineng.net) .When you juxtapose the consequence of an inflation-induced policy on an economy, nay the people who do not posses a corresponding purchasing power by reason of unemployment, the consequences are better imagined than experienced (www.thenationonlineng.net).

Another issue would be that Nigeria will have a greater difficult in paying its external debts, which are on a growing trajectory. Earning less foreign exchange in the face of growing external debts is an ill-wind that blows no one good. (www.thenationonlineng.net) . This is perhaps a pathetic situation Nigeria finds herself.

Moreso, another possible consequence is a round of successive devaluations. For instance, trading partners may become concerned that devaluation might negatively affect their own export industries. Neighbouring countries might devalue their own currencies to offset the effects of their trading partner's devaluation. Such "beggar thy neighbour" policies tend to exacerbate economic difficulties by creating instability in broader financial markets. (www.newyorkfed.org).

Challenges of Devaluation in Nigeria

In Nigeria's case, a number of factors prevent us from benefiting from our currency devaluation since its inception.

i. Lack of Adequate Infrastructures: In order for a country to create a conducive investment environment, it must have decent infrastructures. Nigeria lacks in basic infrastructures and this in every economic sense increases the cost of production for local companies. For example, a local company that has to pay for petrol in order to run its generator because if power is seized will gain petrol cost, Inaddition to the service cost needed to keep the generator running properly. When these costs are added to the cost of production, selling local goods at less than foreign goods will be difficult because this additional cost would have an effect on profit margin (www.nigerianmuse.com). The sorry state of Nigerian roads equally hampers the expected gains from devaluation.

ii. Lack of Advanced Technology: Companies that are forerunners in the global economy usually sustain such edge through improvement and innovation; they not only perceive a new market need or the potential of a new technology, they also move early and aggressively to exploit such advantage. In order for companies to take advantage of technological advancement, the national level should meet a reasonable standard. Nigerian government has not invested in up-to-date technology for the benefit of its industries and this lack of technological investment has a wrong effect on demand conditions because there is more demand for imports than local products (www.nigerianmuse.com)

iii. The Danger of Corruption: Enticing multinational corporations into setting up production sites in Nigeria is difficult because bribery and other forms of corruption are added cost, which will defeat the advantage of cheap labour multinationals try to find. Since the beginning of free trade and currency devaluation in China, the Chinese economy became the fastest growing economy in the World. (www.nigerianmuse.com).

Corruption in Nigeria is pervasive, frightening and seems uncontrollable. Inspite of the existence of institutional mechanisms such as Economic and Financial Crime Commission, little or nothing is done to stem the tide. This is another daunting challenge aside others above that can make devaluation unworkable.

Conclusion and Recommendations

There is no denying the fact that devaluation has been helpful in solving some economic challenges of some countries at one time or the other. But it is hard to believe that at every time it is adopted in Nigeria, it has left us worse than we were. It is the contention of this paper that rather than seeing devaluation as last resort, government should go back to the basis by doing the needful. The above informed coming up with these recommendations so that economic relief can be sought.

- Diversification of the economy with particular reference to agriculture to attain food security and engage Nigerians in productive ventures.

- Reforming the real sector with a view to giving manufacturing in the country some competitiveness while equally developing the country's oil refining capacity.
- Our fiscal and monetary policies need to be active and respond to the realities of the economy.
- Government has the responsibility either directly or indirectly in providing the needed infrastructures to drive the economy.
- Encouragement of small scale industries that are self-sustaining and capable of generating auxiliary jobs for the mass of the unemployed.

While not claiming that the above recommendations are exhaustive, some feat will be achieved if given the necessary attention.

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