NAIRA DEVALUATION: ITS EFFECTS AND POSSIBLE SOLUTIONS

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Abstract

Devaluation is the reduction in the value of the money of one country when it is exchanged for the money of another country. Devaluation of currency is an attractive option for nation in recession like Nigeria. This study looks at the effects and the possible solution of naira devaluation. The study adopts the use of secondary data of the Nigeria exchange rate spanning from 1972 to 2020.

The study then recommends that the Nigeria government should diversify the economy and that devaluation of currency should be the last resort to the economic imbalance.

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ABSTRACT

Devaluation is the reduction in the value of the money of one country when it is exchanged for the money of another country. Devaluation of currency is an attractive option for nation in recession like Nigeria. This study looks at the effects and the possible solution of naira devaluation. The study adopts the use of secondary data of the Nigeria exchange rate spanning from 1972 to 2020. The study then recommends that the Nigeria government should diversify the economy and that devaluation of currency should be the last resort to the economic imbalance.

Keywords: *devaluation, exchange rate, economy, COVID-19, naira.*

INTRODUCTION

Devaluation is defined according to 6th Oxford Advanced Learning Dictionary as the reduction in the value of the money of one country when it is exchanged for the money of another country. Devaluation of currency when the currency value a nation is deliberately adjusted when exchanged to the currency of another country. Yioyio (2015) asserted that devaluation of a nation's currency is a reduction in the value of money with respect to those goods, services or other monetary units with which the currency of such nation can be exchanged. Hence, the currency of a nation can be devalued when discouraging importation and encouraging exportation of goods and services across the borders of the nation. As such, the persistent decrease in the exchange of foreign currency to naira can be backed dated to the introduction of the adjustment programmes in 1986 and it has generated both on concern over the increased inflation and the reduction in the hope of improving the output level of Nigeria. This concern derives from the experience of countries such as Mexico and Argentina where real depreciation of their domestic currencies have consistently been associated with a decline of output and an increase in inflation (Akinlo & Odusola, 2003). Currency devaluation clinches to the fiscal policy which focal point on a calculated cutback in the value of the domestic (a nation, say Nigeria) currency to maximize gains in trade (Aiya, 2014 as cited in Udo *et al,* 2018).

Aguiar (2005) as cited in Okaro (2017) states that a nation experiencing the balance of payment deficit has to adopt both short and long term measures to correct the dis-equilibrium, and one of the measures is to be devalue the nation's currency related to another nation's currency, group of currencies or standard. Nigeria in 1973 cuddles her first currency devaluation at 10 percent in response to U.S. devaluation of the same year at foreign exchange reserves growth at 773.5 percent in 1974 (Udo *et al,* 2018). According to the International Monetary Fund (IMF) report in 2015 revealed that nations can devalue their currency to correct the elementary disequilibrium in the trade and balance of payments. However, Todaro (1982) in Udo *et al* (2018) argued that devaluation is unhealthy for economic development since valued currency has equally worsens trade and balance of payment of a particular nation.

Moreover, the question is that, can our naira be invested upon? Can it improve the strength of our goods in Nigeria as compared to other nation's currency? What are the effects of devaluing naira to the economy? The objective of this paper is to know the effects of naira devaluation, and its possible solutions to the Nigeria economy.

Why does Naira Devalue?

Devaluation of a currency globally is the end product of declining the nation's currency in relation to major currencies of the world. Since 1986, the Nigerian naira's relationship with the U.S. dollar (and other foreign currencies) has been erratic, predictable and unpredictable, violent and of course full of tears and heart break to the citizens, government and the economy as a whole. The devaluation of naira can be compared to its most compared currency, dollar. Dollar has an effect on many nation's currencies due the of the economy and that many citizens of different nations tend to exchange, import goods from the U.S. and as well look up to the currency. The U.S. dollar is looked upon due to the fact that historically the played a significant role in the colonization of most African nation and some nation around the globe. As such, the currency of the United State is regarded as the giant currency as being compared to by many nations. This shows that when the dollar sneezes, most nation's currency is affected due to other nation's dependency, and especially the naira.

Akpan & Atan (2012) as cited in Okaro (2017) the government of the day rely on foreign exchange reserve generated from crude oil to manage excessive volatility in exchange rate that exerts severe strain on the foreign exchange earnings. It is evident that the demand for foreign exchange as continuously been on the rise in the past few years as a result of factor like dependence on imported finished products, reversal of capital flow by investor and high speculative demand which has caused uncertainty in the foreign exchange market which also is caused by increased demand for foreign exchange in the face of unstable supply. They further asserted that also the increasingly adverse balance of payment position and the inflationary pressures which the economy found itself in which also affects the Real Gross Domestic Products (RGDP) of the economy.

Flowing from a report from Robert Brand (2020) where he asserted that the plunge in the oil prices is pilling pressure on Nigeria to devaluate the naira as dwindling export revenue depletes foreign-exchange reserves, curbing the central bank’s ability to support the currency. Emele and Alonso (2020) also stressed that the central bank’s reserves have fallen by 20 percent in the last two years, to the lowest level since November 2017, and may soon go below the $30 billion mark established by Governor Godwin Emefiele for the country’s to consider devaluation.

From a report from the Central Bank of Nigeria spokesman, he said “there is a significant chance it will depreciate more than that because of oil prices and the pandemic disease (coronavirus), they said. He also said that central bank didn’t immediately respond to a request for comments, and that a weaker naira would boost the government revenues by allowing dollar earnings from oil to be converted at a higher rate”. It should also be further that the devaluation is likely considering oil-exporter peer devaluation and an overvalued starting point. In addition, the Nigeria’s Central Bank will migrate to a single exchange rate for the naira by collapsing the multiple exchange rate policy that determined the value for the local currency, people with direct knowledge. It was forced to move after the global coronavirus pandemic (COVID-19) more than halved oil prices, raising pressure on the currencies of crude-dependent economies like Nigeria, Africa’s largest producer of the commodity.

Hence, by making imports more expensive, it protects domestic industries that may then become less efficient without the pressure of competition. Higher exports relative to imports can also increase aggregate demand, which can lead to inflation. It is a reality that devaluation seems to more doom than good. However, over the years, the need to compare the naira to dollar is somewhat needed so as to know the influence and need for naira devaluation.

History of Naira to Dollar Exchange Rate

Year	Currency ($1 to ₦)	Exchange Rate
1972	$1	₦ 0.658

1973	$1	₦ 0.658
1974	$1	₦ 0.63
1975	$1	₦ 0.616
1976	$1	₦ 0.62
1977	$1	₦ 0.647
1978	$1	₦ 0.606
1979	$1	₦ 0.596
1980	$1	₦ 0.550
1981	$1	₦ 0.61
1982	$1	₦ 0.673
1983	$1	₦ 0.724
1984	$1	₦ 0.765
1985	$1	₦ 0.894
1986	$1	₦ 2.02
1987	$1	₦ 4.02
1988	$1	₦ 4.54
1989	$1	₦ 7.39
1990	$1	₦ 7.39
1991	$1	₦ 8.04
1992	$1	₦ 9.91
1993	$1	₦ 17.30
1994	$1	₦ 22.33
1995	$1	₦ 21.89
1996	$1	₦ 21.89
1997	$1	₦ 21.89
1998	$1	₦ 21.89
1999	$1	₦ 21.89
2000	$1	₦ 85.98
2001	$1	₦ 106
2002	$1	₦ 113
2003	$1	₦ 127
2004	$1	₦ 130

2005	$1	₦ 136
2006	$1	₦ 131.80
2007	$1	₦ 125.8
2008	$1	₦ 120
2009	$1	₦ 171
2010	$1	₦ 154.8
2011	$1	₦ 165.1
2012	$1	₦ 161.5
2013	$1	₦ 162.9
2014	$1	₦ 199
2015	$1	₦ 300
2016	$1	₦ 320
2017	$1	₦ 305.8
2018	$1	₦ 306.1
2019	$1	₦ 362.59
April, 2020	$1	₦ 382.75

Source: Keetu (2016) *1972-2016

The above table shows the history of naira to dollar from 1972 to April, 2020. From the table above, it shows that during the military regime, the rate at which the exchange rate of naira to dollar being exchanged at the foreign exchange market, most of the citizens were happy even to the extent of exchanging, importing and exporting of goods from Nigeria to other nation's especially the United State. Furthermore, the table then shows that before the emergence of democracy and since the inception of Nigeria's democracy, the exchange rate of naira to dollar has drastically caused a heart break and tears to the citizens, economy and the government itself thereby birthing economic hardship within the nation.

As such, what are the effects of naira devaluation to the Nigerian economy? Is it that there is a positive or negative effects to the economy?

Effects of Naira Devaluation

Eme & Johnson (2010) in their study of Exchange Rate Movement in Nigeria for the sample period of (1986-2010), examined a direct and indirect relationship between the Nigeria exchange rate and Gross Domestic Product. The effect of currency devaluation on the Nigeria economy is a by-product of monetary decision to curb the nation's economy of not collapsing. Devaluation of currency is an attractive option for nation in recession like Nigeria. The effects of devaluation having its positive results also embraces the negative effects on making the importation of goods more expensive, as well as protecting domestic industries thereby making them to be less efficiency and effective without little or no competition among international rivals.

The positive effects of naira devaluation to the Nigeria economy are:

1. It encourages producers of some sectors to increase output and exports.
2. It strengthens the currency (naira) in the course of dwindling oil price (Osundina & Osundina, 2016)
3. Increase in exchange rate leads to increase in output, and the improvement in balance of payment is neutralized by the use in price.
4. Demand for imports to domestic produced goods by increasing the relative price of imports and making export industries more competitors in international market.

On the other hand, the negative effects of naira devaluation to Nigeria economy are:

1. It affects business by increase in inflation.
2. It reduces the purchasing power of the citizens.
3. Increase in unemployment.
4. It tightens the monetary framework of the nation.
5. It allows a degree of flexibility in exchange rate.
6. Increase the price of domestic goods.
7. Higher export relative to import can also increase the aggregate demand which can also lead to inflation.

RECOMMENDATIONS

The Nigeria government should diversify her economic base, create an enabling environment for export oriented manufacturing to grow and instead of devaluation, trade restriction, ban on some selected imports and other monetary measures should be introduced to address the country's balance of payment position (Ofor & Manukaji, 2016). They further recommended that the monetary authorities should do what they can to reduce the temporary increase in prices lest it become permanent and that the Nigerian government should consider devaluation of currency as the last resort to the economic imbalance.

It will be gainful to say that the government should regulate and maintain the stability in the exchange rate of the nation, also from the revenue generated from crude oil, the government should try to give loans to domestic industries so as take-off grant in producing their goods and services. Also, the government should try as much as possible to come up with policies (fiscal and monetary) so as to combat the *deus ex machine* of exchange rate era.

Furthermore, the government (state and federal) should have some decent and conducive infrastructures that attracts the foreign investors around the global. These solutions can also be achieved by diversifying the economy.

CONCLUSION

Devaluation of currency has a significant relationship or role to the development of a nation's economy. It should be noted that currency devaluation has an effect on the production, citizens, importation and exportation of goods, economy and the government itself. It will be of great advantage and comparative advantage if these possible solutions can be followed or implemented. However, it has been noted that the devaluation of Nigeria's currency was a blessing from inception until the emergence of the democracy era of government. It shows that the government has a major role to play both diversifying the economy and striking a balance to the tears and heart break caused overs the years by the existence of naira devaluation.

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