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**ASSIGNMENT**

1. **FEM is the core issue in international finance. Discuss**
2. **How does this affect BOP in your home country**
3. **Explicitly show the issues in FEM using your home country as the case study**

**ANSWER**

* 1. **FEM is the core issue of international finance**

As you know, money is anything that is accepted as a medium of exchange. In most of the world, people accept pieces of paper imprinted with pictures of national heroes or local wonders of nature as money. But in each nation, they accept different pieces of paper. International finance is the examination of institutions, practices, and analysis of cash flows that move from one country to another. In other words, it pertains to the financial affairs of government institutions, their investments and how this impact a currency's value on the international market. There are several prominent distinctions between international finance and its purely domestic counterpart, but the most important one is exchange rate risk. Exchange rate risk refers to the uncertainty injected into any international financial decision that results from changes in the price of one country's currency per unit of another country's currency. Examples of other distinctions include the environment for direct foreign**,**new risks resulting from changes in the political environment, and differential taxation of assets and income**.**

International Finance is an important part of financial economics. It mainly discusses the issues related with monetary interactions of at least two or more countries. International finance is concerned with subjects such as exchange rates of currencies, monetary systems of the world, foreign direct investment (FDI), and other important issues associated with international financial management.

Like international trade and business, international finance exists due to the fact that economic activities of businesses, governments, and organizations get affected by the existence of nations. It is a known fact that countries often borrow and lend from each other. In such trades, many countries use their own currencies

The world relies on the foreign exchange market. When buying foreign goods and services or investing in other countries, individuals and companies need to purchase the currency of the country where they are transacting business. Currencies are traded everyday in the FX market to be used for direct foreign investments, import and export needs of companies and individuals, purchases of foreign instruments, and managing existing positions. In addition, the FX market is often used as a means to obtain profits from short-term fluctuations of exchange rates. The U.S. dollar, the euro and the Japanese yen dominate the foreign exchange market. These hard currencies, representing the world's largest industrialized economies, are always in demand and make up 80% of the FX market trades.

Foreign exchange management begins with trading currencies to exchange goods and services overseas. International businesses convert overseas profits back into their domestic currency to spend at home. Meanwhile, consumers exchange domestic currency for foreign banknotes to buy overseas goods. These transactions occur within the foreign exchange markets, where networks of private individuals, banks and organized financial exchanges provide the infrastructure to trade international banknotes. Effective foreign exchange management requires you to preserve purchasing power by staying current on any events affecting rates and operating accordingly. Foreign exchange management requires its participants to enter the market to deliver and accept currencies at fluctuating exchange rates. From there, individuals may either hold foreign currency in reserve to make payments or return overseas profits back home in the form of domestic banknotes.

Foreign exchange management must also identify the distinct risks of transacting global business. Adverse shifts in currency valuations can translate into losses. For example, exporters lose sales when domestic exchange rates strengthen. At that point, exported goods become more expensive to foreign buyers. Further, businesses that hold large foreign exchange reserves also lose purchasing power at home when the domestic currency values appreciate. Meanwhile, consumers face the risks of declining domestic exchange rates that increase the costs of imported goods and overseas purchases.

* 1. **HOW DOES THIS AFFECT THE BOP IN NIGERIA**

It is important to measure the performance of an economy. **Balance of Payment** (BOP) is one way to do so. It shows the big picture of the total transactions of an economy with other economies. It takes the net inflows and outflows of money into account and then differentiates them into sections. Balance of Payment is a statement that shows an economy’s transactions with the remaining world in a given duration. Sometimes also called the balance of international payments, BOP includes each and every transaction between a nation’s residents and its nonresidents. BOP is an account to show the expenses made by consumers and firms on imported goods and services. It is also a pointer to how much the successful firms of a country are exporting to foreign countries.

Exchange rate is a key determinant of the balance of payments (BOP) position of any country. If it is judiciously utilized, it can serve as nominal anchor for price stability. The foreign exchange and balance of payment are some of the key factors of a nation’s Life. They are factors that look into comparing a country’s relationship with other nations. In 1973 and 1979, the exchange rate was relatively stable as a result of the oil boom. Nigeria however, started recording huge balance of payment deficits and very low foreign reserve in the 1980’s. It was felt that a depreciation of naira would relieve pressures on the balance of payment. Consequently the Naira was devalued and the irony of this policy instrument is that, Nigeria’s foreign trade structure did not satisfy the conditions for a successful balance of payment policy. The country’s foreign structure is characterized by export of crude petroleum and agricultural produce, whose prices are predetermined in the world market with low imports and export price elasticity in demand. Currently, the nation’s exchange rate has fallen and has since been fluctuating. This so far has been due to unfavorable nature of the competing powers of the nation’s currencies and the currencies of the world. The economy for a long time has been struggling to resolve the problems of external and internal imbalances. This has manifested in the disequilibrium, in her balance of payment while causing a balance of payment deficit. Importation has high significant influence on exchange rate fluctuation in Nigeria which results to deficit balance of payments. More than 65% of finished products consumed in Nigeria are imported outside the country thereby, reducing our current account which leads to favorable balance of payments for positive economic growth and development.

During the past two decades, uncertainty in the Nigerian economy has been brought about by economic factors (mainly macroeconomic policy inadequacies) as well as the social and political instability. In addition, there is the perennial problem of governance and lack of grass root participation and democratic principles. Resolution of these stubborn social – political problems will go a long way to reducing perceived uncertainty and increasing foreign confidence in the stability of the Nigeria economy. In turn, this will clear the way for more foreign participation that will mean increase in foreign investment in Nigeria. It is important that the exchange rate is not over valued, because this will result in unsustainable balance of payments and escalating external debt stock. In contrast, the exchange rate should find its equilibrium level to make the balance of payments position viable. Foreign private investment, which includes foreign private direct investment is an important component of aggregate investment, thus it must be encouraged in Nigeria. Thus, macroeconomic policies designed to bring about low inflation, viable balance of payments position and stable exchange rates will go a long way to encouraging a resurgence of foreign private investment in Nigeria.

In conclusion, we found that exchange rate is a determinant of balance of payments position, and its fluctuations steadily affect the balance of payments position. Therefore there is need for export diversification, since the prospects of traditional agricultural export products in the world market are not bright.

* 1. **ISSUES OF FEM IN NIGERIA**

The primary objective of foreign exchange management is to reduce foreign exchange instability and its adverse effect on the economy. Despite government effects to achieve this objective though the Central Bank of Nigeria (CBN), foreign exchange (Monitoring and miscellaneous provisions) decree No.17 promulgated in 1995 and the introduction of the use of forms A and M, a handled problems are still identified with foreign exchange operation in Nigeria.

        There problem include

i.            Inadequate inflow of foreign exchange

ii.          Balance of payments problems: BOP disequilibrium is a reflection of disequilibrium in the money market (IMF, 2000). Monetary disequilibrium produces adverse effect on the aggregate expenditure for goods and services (absorption) in the sense that, if the public has an excess supply of money it gets rid of it by passing its excess cash balance to foreign countries in exchange for goods and services. If the public desires to keep more money than it has in stock, it achieves it by reducing absorption and ultimately passes goods and services on in foreign countries in exchange for money. The disequilibrium in the country’s balance of payments account have generated questions concerning the causes, its impact on social progress and what policies to adopt to achieve favourable balance of payments position.

iii.        Debt services burden: The African Development Bank (AfDB) has revealed that Nigeria spends over 50 percent of its revenue on debt serving. In its West Africa Economic Outlook 2019, the AfDB put the average revenue spent by West African countries on external debt servicing at 17 per cent. This, it says, is high and even much higher in Nigeria which spends about 50 per cent of its revenue on external debt servicing alone.

 According to the AfDB, with increased domestic debt already incurred by Nigerian government, there is an intense pressure on the percentage of revenue spent on debt servicing. This has raised Nigeria’s debt burden by as much as 128 per cent in the last eight years, even though Nigeria’s debt to Gross Domestic Product (GDP) remains low. The low debt-to-GDP ratio notwithstanding, the African Development Bank cautioned Nigeria that the rising debt burden was due to the high proportion of revenue spent on debt servicing.

iv.         Continuous depreciation in the value of the naira.

v.           Problem of funding sectorial allocation of foreign exchange in the foreign exchange market.

The reason for this isn’t far-fetched – most times Nigeria prefer import to produce, and export; and as the country’s population increases the demand for imported goods increased. Due to the unbalance of import to exported goods, the demand for dollar is always on the rise, which generally causes a continued depreciation of the naira. Depreciation is steadfast at the parallel market and the gap between naira’s value at the parallel and official market widens easily due to this imbalance. To checkmate this, the CBN has devalued the currency a number of times, only for the same thing to happen years later.