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ECO314 ASSIGNMENT

QUESTIONS

1. Foreign exchange management is the core issue in international finance. Discuss.
2. How does this affect the balance of payment of your home country?
3. Explicitly show the issues in foreign exchange management using your home country as case study.

ANSWERS.

* 1. Any business associated with international trade will be at risk to fluctuation in exchange rate⁸ between currencies which would then make the cost of import to increase and the value of export to reduce. This would create a huge impact on the cash flow of the business.

A problem that arises is complex payment schedule. The most complex payment schedules are experienced by importers and exporters. If the business sells as a wholesale or directly to customers, whichever, it is likely to accept payment in one currency and make payment in another. And it is also possible to have different currencies running through the business at any given time. So it is possible for a mix up to happen where the wrong vendors receive their money. And also mismanaged movement of money in the face of the fluctuating currency market.

Another problem is managing currency volatility. As currency market constantly shifts, if importers and exporters are receiving and making payment without being aware of the shift it could be losing money with each transaction. The risk that comes with the management of currency is not all about making your cash go further in the global market place, but also about hedging against those market fluctuation. Observing the global exchange market is a very good way to avoid unfavourable currency valuations.

Incorporating variable costs is another issue that occurs. In a business or industry, costs and sales could be linked to multiple commodity markets. This creates another difficulty when it comes to managing your global payments. Importers and exporters needs to take into consideration duty payments and taxes payable to different countries and regions and also the currencies in which those payments need to be made. The different layers of currency exchange together with the flow of money on and out of different business accounts makes it even more hard for import and export businesses to have a foreign exchange specialist on their side.

* 1. The constant exchange rate fluctuation invariably devalues the worth of Nigeria naira against dollar and increased the cost of importation which transcends to inflation and high cost of living in Nigeria as well, kept on affecting the growth of the economy.

Also, export earnings has a strong important relationship with the exchange rate in Nigeria both in statistical relationship and expectation term.

Importation has a high important power over exchange rate fluctuation in Nigeria which leads to deficit balance of payments. Finished products of more than 55% consumed in Nigeria are imported outside the country which then reduces our current amount which leads to a good favourable balance of payment for positive economic growth and development.

Ever since, Nigeria has continued to fail to notice the local products and patronizing the foreign imported products, the exchange rate volatility will keep swinging to devalue the domestic currency (Naira) when there is too much demand on foreign currencies. Olisabede (1991) has discovered that some of the issues of effective exchange rate management is due to the fraudulent practices by the operators of foreign exchange rate market. This is why there should be need for government to pay notable attention on the practitioners of the foreign exchange rate transaction. And also government should allow export promotion strategies in order to keep a surplus balance of trade, this would strengthen the domestic currency and it would also stop the decrease of the Nigerian currency, Naira. And there should be a sound monetary policy in the country.

1. An issue of foreign exchange management in Nigeria is that foreign exchange has worsen because of the continuous dependence of price of crude-petroleum, the Nigerian major foreign exchange earlier in the world market. In all positivity, Nigeria is also endowed with abundant natural and human resource and can use this to control all resources for it’s economic development. The management of foreign exchange is a huge challenge to the monetary authorities. How a country participates in international trade determines it’s involvement in foreign exchange management. The Naira exchange rate is possibly one of the most problematic preoccupations of the Nigerian monetary authorities since after the establishment of the second tier foreign exchange management in 1986. Inadequate supply of foreign exchange remains a major problem as the CBN is the main producer of funds to the market.

Another issue is that there is imbalance in demand and supply of foreign exchange currencies. In most of the developing countries, this is a major challenge. But in the case of Nigeria, we rely heavily on imported goods. Nigeria has become an import base economy because of out new found sudden wealth in oil as a main source of foreign exchange. And as at so, this has made us import most things which includes consumer and luxury goods, which we can easily do without.

Another issue is the inconsistency in government policy that has impeded advancement in industrialization. Our industries over the years has fallen apart. This has then given our country more reason to import as it has compounded our import-dependency.

Another cause is simply due to corruption. As most leaders chooses to embezzle our money and to “safe" keep them in foreign account outside Nigeria. And at such, when there is need for development projects, the money is then not available thus hindering employment and is mismanaging foreign exchange. Thus reduces the supply end and increases the demand train. Another form of corruption is a case of financial and fiscal indiscipline whereby goods that are not expected to come into the country find their way in thereby denying us of revenue and foreign exchange.

A case of Nigerian government unnecessary foreign borrowings for years. When this happens, the repayment for these loans will be carried out by our meagre foreign exchange earnings.

Most parts of our financial and economic policies were given to us by the western world, so we lack economic and financial independence from our colonial masters. These policies are made to weaken our economy and our leaders agree with such even as they know that it’s not in the favour of our economy. This is so because of their inherent personal financial gains.

And lastly is simply because of Naira, the Nigerian currency. Naira is not a convertible currency and so it clings to apron-string of one or more of the major currencies. Whereas if there is a bad change in “dollar" and or “sterling pound” it would directly affect “Naira”.