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DEPARTMENT: ECONOMICS

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INTERNATIONAL ECONOMICS ASSIGNMENT

Question:

1. Foreign exchange management (FEM) is the core issue in International Finance. Discuss.

b. How does this affect the Balance of Payment (BOP) of your home country?

2. Explicitly show the issues in FEM using your home country as case study.

1. **FOREIGN EXCHANGE MANAGEMENT AS A CORE ISSUSE OF INTERNATIONAL FINANCE**

International finance is also referred to as international macroeconomics, is the study of monetary interactions between two or more countries. It focuses on areas such as foreign direct investment and currency rates. International finance deals with the multiple countries, rather than focusing on individual markets. It analyzes some key concepts which are The Mundell-Fleming Model, International Fisher Effect, The optimum currency area theory, Purchasing power parity, Interest rate parity.

Foreign exchange management is the process of limiting a company’s exposure to foreign currency fluctuations. In most cases this is done by companies that engage in foreign trade. It differs from foreign exchange risk management in as much it is the management of the various currencies purchased or received and the relevant payments.

Foreign exchange management is a core issues in international finance because one of the components of the international finance is foreign exchange market. The foreign exchange market is also known as FOREX, it is a medium of interaction between the buyers and sellers of Foreign Currencies by way of payment for transactions or by physical exchange of currencies.

The participants in the foreign exchange market include the Central Banks, Ministry of Finance, large commercial banks which are authorized dealers, the small retail traders also play a very minor part in the foreign exchange market. The foreign exchange market have unique characteristics which are liquidity of the market, the volume of trading, geographical dispersion, the number and variety of market traders, the 24 hours trading day excluding the weekends. All banks in the world are involved in foreign exchange trading, but Tokyo, London and New York are the main trading centers which allows the market to remain open for 24 hours a day.

The foreign exchange market has made the world’s business transaction easier. When investing in other country or buying foreign goods and services, individuals and companies has to purchase the currency of the country where they are transacting business. The currencies are traded every day in the foreign exchange market are used for direct foreign investment, import and export needs of companies and individuals, purchases of foreign instruments, and managing existing. The foreign exchange market is used as a medium 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 which make up about 80% of the foreign exchange market.

The foreign exchange management ensures that a countries available exchange resources meets the needs of the economy for it be optimally deployed. The FOREX market needs the foreign exchange management to put in place efficient management strategies to enhance the disbursement of available resources. The foreign exchange management had the following objectives;

* Export Promotion: exports constitute a major determinant of the foreign exchange inflow which has been promote over the years. For a country like Nigeria who’s economy has a high dependence on the external sector, her authorities has tried to raise the level of export promotion and the diversification of the export base.
* Trade and Exchange Controls: this was to promote the production and consumption of local made goods and ensure that foreign exchange reserves are adequate to guarantee balance of payments stability.
* External Reserves Diversification: reserves diversification is to optimally apportion a nation’s reserves assets among various reserve currencies so as to ensure maximum returns and minimum losses in case of fluctuation, while at the same time ensuring that liquidity problems are minimized in daily foreign exchange transactions.
* Exchange Rate Management: the exchange rate mechanism was expected to result in a more rational allocation and utilization of foreign exchange resources and reduce foreign exchange volatility, thus making foreign exchange management less difficult.

B. **THE EFFECT OF INTERNATIONAL FINANCE ON BALANCE OF PAYMENT IN NIGERIA**

Balance of payment is a systematic record of all economic transaction between a country’s residents and the rest of the world. It shows a classified record of receipts on goods exported, services rendered and capital received by residents and also payment made by them for goods imported and services received from the capital transferred to foreigners. A country’s balance of payment reveals whether to save enough to pay for its imports or whether the country produces enough economic output to pay for its growth.

Balance of payment is a component of international finance, as international trade result in a flow of capital between countries. The international trade includes the export and imports of goods and services, capital inflow by individuals, companies and government agencies across countries. Balance of payment has three components, they are the current account, the financial account and the capital account.

The current account is usually the largest component of the balance of payment measures a country’s international trade plus the effect of net income on investments and direct payments. The financial account measures the changes in domestic ownership of foreign assets and foreign ownership of domestic assets. The capital account is usually the smallest component of the balance of payment and it measures the financial transactions that do not affect a country’s income, production, or savings.

All financial account of individuals, companies could either be surplus or deficit just like a country’s balance of payment. It can be surplus when the country receives more money from the other countries than it paid out and it is a deficit when the country receives less money from other countries than it paid out. In the 4th quarter 2018, Nigeria recorded a surplus of $2.8m lower than the surplus of $6.18bn it recorded in the corresponding period of 2017 but higher than the deficit of $4.52bn recorded in the 3rd quarter 2018. Between the 3rd and 4th quarter of 2018, Nigeria was able to reduce its imports and increased its export of goods.

Nigeria like every other country in the world has had both a surplus and deficit balance of payment at a point in time. When it had a deficit the country tried to reduce the level of import and increase the level of export to fill the gap. Then when it had a surplus balance of payment the extra income is used as revenue for development plans and to improve the foreign exchange market.

1. **ISSUSES OF FOREIGN EXCHANGE MANAGEMENT IN NIGERIA**

The Nigerian foreign exchange management has had a lot of challenges and issues over the years. This issues include the following;

* Imbalance in demand and supply of foreign exchange currencies: Nigeria relies heavily on imported goods than local made goods. This has resulted in an adverse balance of trade and payment with our trading partners making us to have a deficit balance.
* Inconsistency in government policies: over the years there has been inconsistencies in government polies which has tempered with the industrialization progress. Most of our industries have collapsed, thereby contributing to our import dependency.
* Monolithic economy base: Nigeria’s economy relies on the oil and petroleum sector as our major source of foreign exchange earnings. Before the discovery of oil in Nigeria, our economy was focused on agricultural sector products for our foreign exchange earnings. After the discovery of oil the agricultural sector was neglected and the foreign exchange earnings from that sector was lost.
* Corruption: Nigeria is well known for its corrupt practices by the political leaders. The money earned from foreign exchange are meant for development projects and to generate more foreign exchange. Such money are stolen by corrupt leaders and are not made available when needed resulting to the imbalance in the foreign exchange.
* Unnecessary foreign borrowings by the government: over the year the Nigerian government have being collecting unnecessary loans from the World Bank, IMF etc. the repayment of these loans are mostly done from our meager foreign exchange earnings and with very high interest rates.
* Financial and fiscal indiscipline: most of our land borders are porous with a lot of corruption. Contraband goods are been smuggled into the country thereby reducing the revenue gotten from foreign exchange.
* Lack of economic and financial independence from our colonial masters: Most of our financial and economic polies are dictated to us by the western world even when they are designed to weaken our economic and financial sector. Our leaders agree to such polices even when they know it’s not in our best interest because of their selfish desires.
* The Naira is not a convertible currency: the Nigerian currency naira is not a convertible currency so it depends on other major currencies e.g. dollar and sterling pound. Any change in these currencies rates also affects the naira.

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