**NAME: Akpan .U. Monday**

**COURSE: International Economics**

**COURSE CODE: Eco 314**

**MATRIC NO: 17/SMS01/005**

**What is international finance?**

International Finance is an area of financial economics that deals with monetary interactions between two or more countries, concerning itself with topics such as: currency exchange rates, international monetary systems, foreign direct investment, and issues of international financial management including political risk and foreign exchange risk inherent in managing multinational corporations.

The World Bank, the International Finance Corporation (IFC), the International Monetary Fund (IMF), and the National Bureau of Economic Research (NBER) are some of the notable international finance organizations.

Some of its key concepts include: Interest rate parity, purchasing power parity, the optimum currency area theory, the international fisher effect and the mundell-Fleming model

**Foreign Exchange**

Foreign exchange is the means of payment for international transactions. It is made up of convertible currencies that are generally accepted for the settlement of international trade, foreign remittance and other external obligations. Convertible currencies such as British Pound Sterling, German Deutsche Mark, United States Dollar, Japanese Yen, French Franc, Italian Lira and the Canadian Dollar constitute the basket of currencies for determining the exchange rate of other nation’s currencies

Foreign exchange identifies the process of converting domestic currency into international banknotes at particular exchange rates. These transactions present distinct ramifications for the global economy. Foreign exchange rates affect international trade, capital flows and political sentiment.

However, 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.

However, Effective foreign exchange management requires you to preserve purchasing power by staying current on any events affecting rates and operating accordingly. You will exploit the buying power of high exchange rates to acquire overseas goods. Alternatively, low exchange rates are an opportunity to boost overseas sales, as your wares become relatively cheaper overseas.

**FEM as a core issue in international finance**

International trade deals with a lot of exports and imports and the relationship between a country’s import, export and its exchange rate is complicated as it affects the value of domestic currency. On a positive side a stronger domestic currency gives room for cheaper imports.

However, the inability to manage foreign exchange effectively may cause some major discrepancies in the international finance area, this might be as a result as major fluctuations in currency exchange rates which may affect the rate of inflation in a number of direct and indirect ways which include: changes in price of imported goods and services changes in growth of exports etc.

1. **How does it affect balance of payment:**

A nations balance of Payment shows records and summarizes international financial transaction for a specific period. It primarily comprises of three accounts; current account, capital account and reserve account. It provides info on how many goods and services a country exports and imports, evidence that a country borrows or lends out money to other countries. Balance of payment keeps the complete record of a country’s trade, net foreign asset, imports and exports of goods, financial transfer and financial capital. The balance of payments is one of the most important statistical statements for any country.

A change in a country's balance of payments causes fluctuations in exchange rate between its domestic currency and foreign currencies. The reverse is also true when a fluctuation in relative currency strength can alter the balance of payments. There are two different and interrelated markets at work: the market for all financial transactions on the international market (balance of payments) and the supply and demand for a specific currency (exchange rate). The balance of payments does not impact the exchange rate in a fixed-rate system because central banks adjust currency flows to offset the international exchange of funds. This is not the case in our time because the world has not operated under any single rules-based or fixed exchange-rate system since the end of Bretton Woods in the 1970s.

1. **Issues in FEM using Nigeria as a case study;**

The need to manage foreign exchange became imperative as a result of this equilibrium in the foreign exchange market caused by inadequate supply of foreign exchange management is a conscious attempt to harness foreign exchange resources deploys them to service the economy so as to prevent the economy from experiencing shocks due to foreign exchange volatility.

The management of foreign exchange in Nigeria has come a long way from the days of the military regimes when exchange rates were determined by military fiat up till now when there appears to be some semblance of stability in the value of the Naira. It is, however, a matter of regret that this seeming stability has come at a great cost. The value of the Naira has gone through thick and thin, through devaluation, revaluation, and some other methods of extrapolation.

The foreign exchange management in Nigeria has had a lot of challenges and limiting factors over the years. Some of these limitations include, but not limited to the followings

 i. Imbalance in demand and supply of foreign exchange currencies: This is a major challenge in almost all developing countries. However, our peculiar situation in Nigeria is more acute because we rely heavily on imported goods. This is closely related to the issue of adverse balance of trade and payment with our trading partners.

 ii. Another limitation to our Foreign exchange management is due to our monolithic economic base. We rely heavily on oil as our major source of foreign exchange earnings. Before the advent of oil in Nigeria, our economy was doing quite well with Agricultural product such as Cocoa, Rubber, Cotton, Groundnut etc. driving our Foreign exchange earnings. This has changed drastically since the discovery of oil, the Agricultural sector has been neglected and Foreign exchange earnings from that sector lost.

 iii. Again, Nigeria has become an import-dependent nation because of our new found sudden wealth in oil. We now import virtually everything , including consumer goods and luxury goods that we can easily do without.

iv. Another limitation is the inconsistencies in government policies that have hampered progress in industrialization. Most of our industries have collapsed over the years, thereby contributing/compounding our import-dependency.

v. Corruption is another challenge or limitation in our Foreign exchange management. Most of our leaders prefer to steal our money and keep such in foreign account outside Nigeria. Such monies are not available for the needed developmental projects that could generate employment or even generate further Foreign exchange. This reduces the supply end and increases the demand train.

vi. Unnecessary Foreign borrowings by our governments over the years. Most of the repayment of these loans will be done from our meagre Foreign exchange earnings and we pay interest at very high rates thereby eroding Foreign Reserves the more.

vii. Financial and Fiscal indiscipline are another limitation in our Foreign exchange market Management. Our borders are porous and a lot of corruption is evident. Goods that are not expected to come into the country find their ways in thereby denying us of revenue and Foreign exchange.

 viii. Lack of economic and financial independence from our colonial master. Most of our financial and economic policies are dictated to us by the western world. These policies are designed to weaken our economic and financial sector. Such policies are forced down our throats and these task masters pretend to be doing us some favour. Our leaders and economic advisers condescend to agree with them even when they know that such policies are not in our interest. This is done because of their inherent personal financial gains or some hidden political/economic agenda.

 ix. The Naira is not a convertible currency and so it clings to the apron-string of one/more of the major currencies, e.g. the dollar and or Sterling Pound; any adverse change in the rate of such currencies directly affect the Naira whereas positive change are not reflected in the Naira exchange rate. So it is a question of when the Dollar or Sterling sneeze, the Naira catch cold.