Exchange Rate Unification Policy in Nigeria: The Implications for the Economy

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ABSTRACT

This study examined the implication of exchange rate unification policy on the Nigerian economy. The basic objective of the paper is to benefits and implications of exchange rate unification on macro and socio economic variables. Data for the study was collected via library science method. The findings showed that, the benefits of exchange rate unification include but not limited to efficient price discovery, access to foreign exchange supply, increased capital importation, and brings about investor confidence in the economy. But the implication of the unified exchange rate regime is that, it brings about naira depreciated which was accompanied by high increase general price level of goods and services especially food inflation. Also, socioeconomic variable like poverty rises in the short run, and this in turn will increase consumption cost vis-à-vis high energy prices and many more. Based on the findings, the paper suggested the temporary suspension of the unified exchange rate regime since the policy cannot work effectively in a consumption economies of which Nigeria is one. Also, government should encourage farmers to produce finished goods for exports in order to improve the value of the naira.

Keywords: Exchange rate, Inflation, Naira's value, Regime, Unification Policy

INTRODUCTION

The global economies are becoming more integrated through the exchange of goods and services via the currencies exchange rate system. Exchange rate is central to macroeconomic determinant and it is the key price variable in any economy with the mandate of maintaining global competiveness and fixing domestic prices. Thus, Exchange rate can best be described as "the price of one domestic currency expressed in terms of another foreign currency" (Gbosi, 2019). Also, Omekwe and Obayori (2019) defined exchange rate as the value of the US Dollar compared to that of the Nigerian Naira and can be converted; through direct and indirect methods. The direct method expresses the exchange rate as the price of domestic currency in terms of one unit of foreign currency, for example, ₦1,530.00 = $1, while the indirect method expresses the exchange rate as the price of foreign currency in terms of one unit of the domestic currency, for instance, ₦1=$0.00153 (Central Bank of Nigeria (CBN, 2024).

Exchange rate management policy in Nigeria, however, has never been easy prompting the Central Bank of Nigeria (CBN) from her inception till date to adopt different exchange rate management strategies in order to either achieve improved exports of goods and services or maintain relative price stability in the country. There are two extreme exchange rate regimes at use in Nigeria; the fixed and the floating exchange rate systems. However, Nigeria also practiced the manage float exchange rate regime and by mid-2023, the nation adopted the exchange rate unification (Zakari, Bakkihs & Asue, nd)

Following the foreign exchange rate unification policy of the CBN in Nigeria in June 2023, the country's currency (the Naira) tend to have depreciated very fast and the prices of goods and services within the same period tend to have also risen very fast. This calls for concern because exchange rate unification that ought to have been a blessing to the Nigerian economy is now a curse to the economy as a result of depreciation of the value of the naira and hyperinflation in the nation. Also, Nigeria exchange rate unification policy of the year 2023 was meant to enhance transparency and appropriate price discovery in the foreign exchange market, minimize the level of government intervention in the market, increase the supply of foreign exchange; attract high in capital importation and to unlock of some investment opportunities and jobs creation (Ozili, 2024).

However, for over one and half years since the government adopted the policy, the naira appear to be depreciating very fast and it is the 10th weakest currency in Africa (Alausa-Issa, 2024). For instance, the value of the naira to a United State Dollar for example depreciated fast from ₦ 458 in May 2023 to ₦ 1249.82 in May 2024 and by May 2025 it has depreciated further to about ₦ 1530.00. Consequently, the unofficial estimated inflation rate rose from 10.76 percent in May 2023 and skyrocketed to 105.16 per cent in the last quarter of October 2024 (World Bank, 2024).

It is against this background that; this paper examines the implications of exchange rate unification policy on the value of the naira and inflation rate in Nigeria. The rest of this study is segmented into; concept of exchange rate, exchange rate regimes,

METHODOLOGY

The paper used library science method where published information for the study were gathered from various literatures on the subject matter. This method relies on secondary data on the subject matter. Thus, the data sources include the Central Bank of Nigeria statistical bulletin, text books, World Bank databases and other relevant exchange rate regimes literatures

Exchange Rate Regimes in Nigeria

Exchange rate regimes in Nigeria can be classified into two. Namely Fixed/Regulated exchange rate regime which coincided with the period before 1986, specifically between 1960 and 1985; and the Flexible/Deregulated exchange rate regime which is the period after 1986 (George-Anokwuru, Obayori & Oriji, 2018). After the collapse of the Bretton Woods system in the 1970s (the period when currencies were pegged to gold), different government chose exchange rate regimes they deemed suitable for their economies. In Nigeria, different exchange rate frameworks have been employed (fixed, floating, dual, and managed float exchange rate regime).

The Fixed (Pegged) Exchange Rate System

In this exchange system, governments commit to sustaining their currency's convertibility at a predetermined rate (Begg, Fischer & Dornbusch, 1984). This system allows for the Central Bank of a country to fix its currency's value relative to another currency or a basket of currencies, and the rate of exchange is maintained within a narrow range and the peg is adjusted occasionally. The fixed regime is suitable for small economies and countries that satisfy the currency area criteria. It promotes low inflation, enhance credibility, foster economic growth; impose fiscal discipline and lower international financial market access costs and interest rate (Moosa, 2015).

Fixed exchange rate regime is more suitable to promote domestic and foreign direct investment compared to flexible regime. However, Eregha, Ndoricimpa, Olakojo, Nchake, Nyang'oro and Togba (2016) study shows that, under certain conditions (like narrowing current account balances and depleting foreign reserves) the fixed exchange rate regime may deter FDI. Despite their submission, several literatures emphasize that fixed exchange rate regimes can create a more predictable and disciplined macroeconomic environment that is favorable for foreign investment (Salako & Adebusyi, 2001; Cuhman & De Vita, 2017).

Dual Exchange Rate System

This system is a unique feature in Nigeria's experience. The system was operated from 1995 to 1998. The dual exchange rate system consists of the first and second-tier foreign exchange market. The first-tier was administered to serve official transactions, including debt service payment, embassies', and other external obligations, while the second-tier (SFEM) was market-driven and severed all private sector uses (Uchechukwu, 2024).

According to Obadan (2006) the objective of the dual exchange rate framework was to prevent sharp, uniform naira devaluation by allowing depreciation in the SFEM market while the government phased down the official rate, merging both tiers into a realistic market rate. This arrangement allowed for the government to target specific transactions officially, while letting market forces determine the rate for most other activities.

Flexible (or Floating) Exchange Rate System

The flexible or floating regime is a system by which market forces (demand and supply) is allowed to determine the exchange rate. Its standout feature is that government do not intervene through any means, for instance, making transactions that would increase or reduce the foreign exchange reserve (Begg et al., 1984). This system permits the exchange rate to change on its own, without any intervention from the central bank or government authorities. Obadan (2006) posited that, this system is different from the fixed system because it achieves equilibrium in foreign exchange supply and demand by adjusting the exchange rate. Some variations of the floating exchange rate regime are a clean float and a managed float.

Clean float (Independent float)

Under this floating system, the government does not set the exchange rate through intervention – leaving the exchange rate to the market forces; the government only intervenes or takes any action in order to ease the rate of change and prevent excessive fluctuations (Obadan, 2006).

Managed float

This type of float arises when the government actively intervenes in the foreign exchange market to manipulate the exchange rate to achieve a desired benchmark. This system blends a pure floating and fixed exchange rate regime, and it is favoured by many governments that are reluctant to let their currencies float completely (CBN, 2024).

Ozili (2024) averred that between 2014 and mid-2023, the CBN operated a managed-float exchange rate regime. The central bank can maintain the exchange rate at a level set by the central bank or within a range of another currency by implementing a managed float exchange rate system, which is, in essence, an exchange rate regime in which the exchange rate is neither fully floating nor fixed. In order to achieve low inflation, sustainable economic growth, and increased non-oil revenue, the CBN implemented the managed float regime in 2014. That decision was made since it allowed the CBN to control the exchange rate.

The characteristics of the managed float were highlighted as follows:

The floating exchange rate based on market supply and demand;

The range of floating adjustments is based on trade and current account balances to reflect the ‘managed floating’ nature; and

The exchange rate is determined with reference to a basket of currencies, rather than the bilateral exchange rate between the domestic and any single currency.

Willing-Buyer and Willing-Seller Exchange Rate Regime (Exchange Rate Unification)

President Bola Ahmed Tinubu through the Central Bank of Nigeria (CBN) terminated the controlled float exchange rate system in barely a after his assumption of office in the year 2023, precisely, June 2023 and introduced the unified exchange rate regime. The remover of the prohibition on 43 products from entering the foreign exchange market was also announced along with the unification policy. The essence of the policy is to unify the official and black market exchange rates with the objective of achieving “willing buyer-willing seller” principle, which is a form of floating exchange rate regime.

The measure was implemented to protect the foreign exchange market from speculation, maintain stability, and boost public confidence in the value of the naira. The unification of the currency rate was expected to guarantee that, the dollar is valued equally across all known sections of the foreign exchange market. In order to achieve the objective of unified exchange rate, the low official exchange rate was raised to converge to the high parallel exchange rate. Similarly, it was projected that, a high unified exchange rate will cause appreciation of exchange rate, increase inflow of foreign capital, increase inflows of foreign currency, and reduce the demand in the secondary market.

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Benefits of Unified Exchange Rate

Unifying the exchange rate will bring some benefits to Nigeria. Below are some of the potential benefits of exchange rate unification in Nigeria.

Efficient price discovery – Exchange rate unification bring about efficient price discovery in the Nigerian foreign exchange market as a result of merging the official and parallel exchange rates into one market-determined exchange rate, which will invariably market participants to discover the true exchange rate in the market.

Access to foreign exchange supply – Unified exchange rate bring about rise in foreign exchange. This in turn will encourage import substitution among SMEs and export of locally made goods to international markets. Thus, higher export will increase foreign exchange receipts and revenue in the Nigerian economy.

Increase in capital importation – Unified exchange rate will increase capital importation such as foreign direct investment inflows and diaspora remittances to the Nigerian economy. The increase in capital inflows will then lead to reduction in poverty via employment opportunity.

Investor confidence in the economy - The unification of the exchange rate will increase investor confidence in Nigeria by reducing uncertainty and creating a predictable foreign exchange market which are essential to attract foreign investments and attract multinational companies to invest in Nigeria.

Decrease government interference in the market – Unifying the exchange rate lessen government interference in the foreign exchange market. The cost savings can be allocated to other priority areas such as education, welfare, healthcare, and agriculture.

The Implications of Exchange Rate Unification for the Economy

The unification of the exchange rate has implications macroeconomic variables, socioeconomic variables, individual businesses and the government.

Macroeconomic and socioeconomic implication

Macroeconomic variables such as inflation rate rises. The unification of exchange rate may exacerbate inflationary pressures in the short term through an increase in the prices of imported goods, raw materials, and essential commodities. This will increase the cost of living in Nigeria and have an adverse effect on poor and low-income Nigerians. For instance empirical work of Aminu, Ado and Umar (2025) found that, unified exchange rate and exchange rate differentials have a negative and significant impact on food inflation since its introduction. Similarly, socioeconomic variable like poverty rises in the short run, and this in turn will increase consumption cost vis-à-vis rise in energy prices and many more.

Individuals and Households Implications

Households and individuals are affected by the unification of exchange rate as a result of the fact that, greater proportion of goods and services are presently priced at the parallel market exchange rate. Higher price of such goods and services will be expected in the short run due to a higher unified exchange rate, but lower prices are expected in the long run. For instance, students looking for foreign education will easily have access to foreign exchange but at a higher unified exchange rate which will increase the cost of studying abroad.

Businesses Implication

Unifying the exchange rate will lead to a higher exchange rate because the official exchange rate will converge towards the parallel market exchange rate. This bring about increase in the cost of imported goods and raw materials for businesses. This can lead to failure of some businesses that could not pay higher cost to survive. On the other hand, businesses that could afford to pay higher cost will pass such to the final consumers, thereby leading to cost push-inflation.

Implications for the Functioning of Government

Unifying exchange rate will decrease the collection of corporate tax in the short term if businesses face foreign exchange losses due to a higher unified exchange rate. However, government revenue in naira terms will increase due to the sale of foreign currency receipts. As a result, more funds will be available for government. The increased revenue can be used by States to embark on developmental projects that will improve the standard of living of people. Exchange rate unification also has implications for the national debt. Unifying exchange rate will result in a unified higher exchange rate and may lead to increase in government (nominal) debt in naira terms. The increase in national debt due to exchange rate unification will increase the debt-to-GDP ratio and raise concerns about debt sustainability.

CONCLUSION

This paper examined the implication of 2023 exchange rate unification policy on the Nigerian economy. In the month of June, 2023 the president of Nigeria through the CBN announced the adoption of imperfect free float exchange rate system that is based on the willing buyer willing seller principle. The exchange rate regime is slightly close to a free float exchange rate system. The unification of exchange rate is expected to yield potential benefits such as fewer government intervention in the foreign exchange market, improve price discovery, greater foreign exchange supply, and higher inflow of capital. Nevertheless, the unification of exchange rate is also expected to have some positive and negative effects on macroeconomic variables, individuals, households, firms, and the government at large. Adverse effects are expected in the short-term, but it is expected that, these effects will disappear in the long run. While unification of exchange rate is a step in the right direction due to its many potential benefits, the success of exchange rate unification will depend largely on effective implementation and sound macroeconomic policies. Based on these findings, it was suggested that, paper suggested the temporary suspension of the unified exchange rate regime since the policy can work effectively in a production rather than consumption economies of which Nigeria is one. In like manner, the Central Bank of Nigeria should carefully monitor emerging developments in the economy as the exchange rate unification process takes place. Also, government should encourage production of goods that are exports based in order to earn foreign exchange and improve the value of the naira and as well offer long-term stability for the naira in terms of international currencies.

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