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The Politics of Foreign Exchange Reform in Nigeria

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1. Introduction

In the age of interdependence, global markets, rapid capital mobility, and currency speculators, the foreign exchange policies of many governments have achieved the status of high politics. Given the intense interest and controversy surrounding the specifics of their exchange policies, governments have become increasingly jittery about the valuation of national currencies. The high stakes involved place many political leaders in the dilemma of figuring out how to achieve the desirable objectives of exchange rate stability and international finance capital while retaining monetary policy autonomy. The reality, however, is that achieving all three conditions simultaneously is an impossible mission. As Benjamin Cohen (1995) argues, no country can achieve more than two of those conditions at the same time, except by chance. With globalisation and the effective integration of financial markets and economic activities, the pursuit of independent monetary policy leads to balance-of-payments disequilibria that in turn induce negative flows of speculative capital. In order to preserve the stability of its exchange rate regime, a government has only the options of limiting capital mobility through various restrictions and taxes or foregoing its own policy autonomy.

Although the current system of floating exchange rates allows the value of most currencies to be set freely by private traders operating in world currency markets, many governments—particularly of the developing world—prefer to retain a range of less flexible (but more predictable) systems of referential valuation. Rather than allow their national currencies to fluctuate at the whim of currency speculators, such governments adjust the currencies executively, bearing in mind various sets of factors pertinent to their economic and financial circumstances.

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Increasingly, however, government leaders are finding out that exchange rate policies can place them in politically charged environments. The reason for that is simple: the reality of any currency valuation is that its effects cannot be neutral. There are always winners and losers because of the direct impact of any upward or downward movement of rates. Not surprisingly, domestic interest groups seeking to avoid negative outcomes press policymakers for favourable valuation policies. Usually, export-oriented producers favour devaluation while those with domestic orientation or who rely substantially on imported inputs tend to oppose it. The resulting competition for influence and advantage can degenerate into policy-crippling political conflicts.

In this paper, I seek to explain and contextualise the logic of the Nigerian foreign exchange policy between 1986 and 1995. I argue that General Ibrahim Babangida's government was unwilling to allow the national currency, the naira, to float because of political pressure from the financial wing of the economic elite. In principle, this action was intended as a government subvention to the inefficient and import-dependent (albeit highly influential) industrial sector and, by extension, the general society through reduced product prices. However, the putative, felicitous impact of the subsidy was lost as the banking sector 'hijacked' the resultant largesse. I also attempt to explain the political struggle that underscored the unexpected outcome, and how that outcome gave definitive shape to the socio-economic malaise that damaged the Nigerian political economy.

2. The Nigerian Structural Adjustment Program

The basic rationale for the Nigerian structural adjustment program (SAP) was the need to eliminate severe distortions and structural imbalances in the economy. These were aggravated over time by policy instruments, such as extremely rigid exchange controls, import licensing and monetary policy measures. The distortions, in turn, exacerbated the persistently deteriorating balance of payments position. They also led to increasing unemployment, spiralling inflation, severe shortages of industrial raw materials, the under-utilization of capacity, and the scarcity of consumer goods. SAP was introduced to eliminate/reduce relative price distortions, and to restructure the productive base of the Nigerian economy.

In pursuit of the reform program, the Babangida regime imposed a wide array of policy measures. In line with the formal requirements of the

International Monetary Fund (IMF), it introduced bureaucratic reforms, liberalized the exchange and trade regimes, deregulated economic controls and prices, privatised or commercialised public companies, and improved fiscal balance with tighter monetary and fiscal policies. In order to improve the balance of payments and reduce the heavy dependence on oil for foreign exchange, the regime also worked on improving the expansion of non-oil exports, including primary goods and manufactures. Babangida argued at the time that the policy mix was "a more dynamic economic programme that was aimed at altering and realigning aggregate expenditure and production patterns so as to enhance our export base, minimize dependence on imports and bring the economy to the path of steady, balanced growth" (*Newswatch*, 10/5/87: 62).

Theoretically, lowering exchange rates for one country's currency relative to other currencies decreases the cost of that country's goods and services for the external market. However, the Nigerian devaluation policy was driven primarily by other considerations since—like many African and developing countries—most of its exports were commodities that were traded in 'hard' foreign currencies. The other factors included the imperatives of eliminating bureaucratic bottle-necks and corruption associated with exchange regulation, the dire need for the putative allocating efficiency of the free market and, thus, the elimination of the severe distortions in economic policy which encourage non-contributive economic activities as well as the attendant diversion of scarce resources. In other words, Nigerian policy-makers hoped that by reforming the foreign exchange regime to eliminate stultifying distortions, the decaying national productive competence that necessitated SAP in the first place, would be halted and reversed. The key factor that must be kept in mind is that such positive development was primarily anchored on the ability of the policy to arrest the diversion of resources associated with currency overvaluation and foreign exchange regulation.

Not surprisingly, the Babangida government not only placed a high degree of emphasis but also staked its popularity on the corrective capacity of the currency devaluation instrument. However, because of the huge costs and benefits associated with the exact parameters of the policy, the regime was immediately beset with the unpalatable task of attempting to balance the diametrically opposed desires of assorted interest groups. Most of these 'interests' were members of the Organized Private Sector (OPS)[1] and the

'ruling class', and they understood the zero-sum nature of the exchange policy. Perhaps as a result of their easy access to the formulators of official policy, the regime's resolve to stay the course on its policy decisions was shaken. The net effect was the stopgap or halting nature of the actual policy implementation, and the widely held perception that the regime was both inept and seriously misguided.[2] Government officials were seen as clueless as to the consequences of their policy formulations. One cynical observer regarded the policy as one big farce:

> A few lazy heads have been clamouring that SFEM [second-tier foreign exchange market] will inevitably spell the death of the naira, that our economic gurus ... are the hatchet men and our rulers the dutiful undertakers. They complain that the naira which once stood at double the dollar is now barely one third of that all-conquering giant. They claim that even the IMF, whose murderous orders the people of this country unanimously rejected (though that cunning monster has been let in through the back door) merely asked for a 60 percent devaluation. Now we have beaten them at their own game and clobbered the naira by a whopping 500 percent. Call it all patriotic clipping, our own internal solution, our fail-safe process of `structural adjustment' (*Newswatch*, 1/26/87: 42).

Many other observers shared this view that Babangida's exchange rate policy was a Nigerian national tragedy. One reason for this was an undercurrent suspicion about the legitimacy of the policy itself. Some public commentators even questioned the claim by the IMF and the World Bank that the naira was over-valued. Newspaper and magazine headlines blared that the naira was being sent to the 'gallows.' Many 'experts' including some with little or no economics or finance background opined that the naira did not deserve the fate it was being dealt, and should not exchange for more than two to one or three to one American dollar.

3. The Devaluation Imperative

The Deputy Governor of the Central Bank of Nigeria, Victor Odozi, captured the basic problems faced by the managers of Nigeria's exchange rate regime since the introduction of the foreign exchange market with the following words:

> The exchange rate is a price, which, in a free-market environment, is the outcome of the interplay of the forces of demand and supply as mediated by the numerous participants in the market. The massive depreciation of the naira exchange rate with the advent of SFEM has arisen largely from the substantial shortfall in the supply of foreign exchange relative to demand.

> The fact that speculative pressures have also been at work does not invalidate the fundamental issue of supply and demand: indeed, speculative pressures may well be manifestations of uneasiness about an underlying supply inadequacy or the lack of sustainability of the level of official funding (*Guardian*, 1/7/93).

The virulent nature of the criticisms that developments in the market drew rendered the Central Bank's exchange rates policy a volatile political issue in Nigeria. The effects of the policy were made more poignant by persistent problems within the Nigerian economy. For instance, in 1992, after six years of SAP, inflationary pressure remained high at 27 percent (*WA*, 28 Sept-4 Oct, 1992: 1614). With lending rates averaging 55-60 percent, interest rates reached 'outrageous' levels (*Guardian*, 1/7/93: 24). Furthermore, unemployment rates 'skyrocketed' by many accounts; capacity utilization for industries remained anaemic at less than 30 percent; and the depreciation of the naira in 1992 alone stood at more than 300 percent. According to a journalist with one of Nigeria's leading magazines, "... things are 100 percent worse now than a year ago. Most people are merely trying to survive. Everything is either too expensive or out of reach. People are tired of Babangida."[3]

Clearly, the criticisms were not surprising given the significant role played by the exchange rate on household and business decision-making as well as its use by the government as an instrument of micro-economic management. It should be borne in mind that the effects of Nigeria's fiscal indiscipline and exchange policy—particularly the over-valuation of the naira—and the associated misallocation of resources, were crucial factors in the nation's economic woes and, as such, major elements in the initial decision to adopt SAP in June of 1986.

Neither Babangida nor Buhari (his immediate predecessor) was responsible for the over-valuation of the national currency. According to Douglas Rimmer (1985: 438-9), the problem began in 1974 when inflationary pressure forced the detachment of the internal value of the naira from an officially maintained artificial external value. The Yakubu Gowon government decided to tolerate the overvaluation on the grounds that the nation's foreign exchange was both ample and rising. The cheaper foreign exchange enabled the government to moderate cost of living increases—particularly for the middle and upper income families that relied heavily on imported goods and services (see Table 1).

Table 1: Naira Exchange Rates (*Naira per $US*)

	1981	1982	1983	1984	1985	1986	1987
Market Rate+	-	.74	.78	.79	1.10	4.06	5.87
Official Rate*	.61	.67	.72	.76	.89	1.76	4.02
	1988	1989	1990	1991	1992	1993	1994
Market Rate+	7.20	10.06	12.81	14.11	27.01	30.06	43.**
Official Rate*	4.54	7.37	8.39	9.91	17.30	22.10	22.00

+*Source: International Financial Statistics*, 1987-1994
**Source: Economist Intelligence Unit*, 1986-1994
**Estimate (black market rates ranged up to 50)

Two consequences followed. On the one hand, the profitability of exporting was reduced or extinguished for every product other than those (mineral oil and cocoa) whose value consisted very largely in economic rent. On the other hand, the implicit subsidization of foreign exchange increased the demand for this resource, brightening the tendency for additions to money-demand in Nigeria to spill outside the country (Rimmer, 1985: 439).[4]

In effect, resources were being diverted due to government policy from potentially contributive pursuits to unproductive activities. The immediate impact of such distortion was that the policy began imposing severe negative penalty on the national productive competence. To combat the problem, administrative controls on access to foreign exchange were put in place in 1978 under the military government of General Olusegun Obasanjo.

However, President Shehu Shagari's civilian administration quickly reopened the floodgates by removing the restrictions after it assumed office in October of 1979. This was clearly problematic if one considers the structural imperatives of the Nigerian political economy. Regardless of the precise theoretical merits or demerits of exchange restrictions, it must be borne in mind that because of the structure of the Nigerian political economy—particularly its parasitic or pirate capitalist system—exchange decontrol (in the absence of other ancillary reforms[5] and in the context of decaying productive competence) would have net negative consequences for the country. The negative effect of such biased policy can be seen in the average annual growth rate of the various sectors of the Nigerian economy. The over-valuation policy had several crucial effects: it served to subsidize the cost of imported goods and services (utilized by middle and upper income families); it squelched or limited the development and efficiency of

domestic industries because of the effective subsidization of imported goods; it facilitated the massive exportation (and size) of ill-gotten wealth to Europe and North America; and it imposed high costs on rural dwellers and the agricultural sector which were relatively ignored as national resources were diverted to subsidize urban centres and the lifestyle of officials. At base, then, the exchange policy served not only to divert resources from contributive pursuits but also to lay the foundation for Nigeria's deep economic, social and political malaise.

Furthermore, the near collapse of the agricultural sector due to the official emphases on petroleum extraction and rent, and import substitution industrialization strategy also served to signal the need for a new exchange rates policy. Much of the resources earmarked for agriculture went to service official corruption and mismanagement[6] as well as large-scale producers, agricultural companies, expatriate consultants, and agricultural technicians and bureaucrats. The value added in agriculture actually declined (in 1975 dollars) from $9.06 billion in 1970 to $8.56 billion in 1982 (World Bank, 1984b: 228). This situation was exacerbated by the lower real naira prices which rural commodities fetched due directly to the over-valuation and indirectly to the official efforts to keep food prices low for the urban centres.

One obvious general effect of petro-naira and government policies was the nature of its impact on the Nigerian political economy. Nigerian merchandise trade was not only restructured but also grew rapidly due to the decayed productive competence (Graf, 1988: 222-3). Nigerian imports, which previously largely consisted of production-oriented products (industrial equipment, products and raw materials), changed primarily to consumption-oriented manufactures and primary goods. Also, Nigeria became a net (and large) importer of food and raw materials. The average annual growth rates of imports grew from 1.5 percent between 1960-70 to 17.2 percent between 1970 and 1982. By comparison, the average annual export growth rates declined from 6.6 between 1960 and 1970 to minus 1.6 between 1970 and 1982 (Graf, 1988: 234).

Clearly, the naira's over-valuation resulted both in a general decline of national productive competence and increased dependence of the economy on imported inputs and manufactures. It was this realization that formed the basis of the Babangida regime's decision to implement a systematic devaluation policy.

4. Devaluation, Domestic Politics, and Policy Implementation

Clearly, the exchange deregulation regime—as introduced by the Shagari administration on assuming the Presidency in 1979—was problematic. As the consequences of that administration's profligacy catapulted the country into financial ruin, the restrictions were reinstated in March of 1982 by the military government of General Mohammed Buhari. When Babangida assumed office in 1985, he inherited a highly indebted country with minuscule foreign exchange reserves. Nigeria was not only far behind in its payments on non-contractual debts but also its currency was highly overvalued. This was the financial picture despite the austerity program put in place in 1984 by the Buhari/Idiagbon regime. Moreover, the price for the nation's principal foreign exchange earner—crude oil—was continuing its decline in 1985 with even more distressing future prospects. In essence, the sombre economic expectation and the crushing need to reduce the elite commitment to non-contributive activity compelled the new regime not only to seek ways to come to terms with the IMF but also to begin formulating an economic recovery blueprint. The exchange rate policy, which the regime introduced officially in August of 1986 (but actually began many months earlier), was a critical element in the plan to reverse the rapidly deteriorating national productive competence.

4.1 The Foreign Exchange Policy Framework

The Babangida regime anchored its monetary policy on two instruments: a) the Foreign Currency Domiciliary Account, and b) the Inter-Bank Foreign Exchange Market. The liberalization of the Nigerian economy began with the abolition of licenses for import and export activities, and the elimination of 68 of the 74 items on the prohibition list. The abolition of foreign exchange control on all current transactions was designed specifically to eliminate the inefficiency and corruption that mired the system and stunted economic development. For this reason, the 1985 Foreign Currency Domiciliary Account became an integral part of SAP. The previous arrangement whereby Nigerian residents were required to surrender their foreign exchange earnings to the Central Bank of Nigeria (CBN) was eliminated. The new policy allowed exporters and other foreign exchange earners to keep 100 percent of foreign exchange earnings that they repatriate and keep in domiciliary accounts. Under the policy, individuals could draw freely from their deposits to meet their own needs. In principle, Domiciliary Accounts were supposed to both enhance the inflow of foreign exchange into the country and give importers greater flexibility in paying for their foreign

purchases. Furthermore, the accounts were expected to help check the flow of foreign exchange to the illegal parallel market.

Devaluation has been one of the most controversial SAP policy instruments in Nigeria. As one of the principal reform instruments, it was expected to help reduce the heavy reliance on imported manufactures and industrial inputs, encourage increased and more diversified local production, and stimulate non-oil exports. The net anticipated effect was a rationalized investment, production and consumption pattern. For industries, it was expected that the higher costs would lead to more genuine efforts at backward and forward integration, as well as increased interest and investment in research and development. In essence, devaluation along with other measures—a tight squeeze on credit and public borrowing, liberalization—were designed to reward industries with intensive inward looking approach to raw material procurement while punishing or eliminating those with unsustainable external orientation. This strategy, it was believed, would dramatically improve national production levels and productive competence.

The IMF demanded a 60 percent devaluation in 1985 when N1.00 was valued at $1.00. On attaining this 'more realistic' exchange rate, the valuation instrument was expected to help not only effect a more efficient allocation of resources but also stimulate domestic production and exportation of domestically produced goods. Furthermore, a realistic exchange rate for the naira was said to be an indispensable corollary to efficacious trade liberalization. Indeed the theory of exchange rates argues that a lower real rate for any given country's currency would result in increases in its sales of tradable goods and services to foreign purchasers. All this notwithstanding, there was a lingering question about the true extent of the naira's unrealistic valuation.

The naira's devaluation began in earnest with the introduction of the Second-tier Foreign Exchange Market (SFEM) on September 29, 1986.[7] The idea was very simple. Each Thursday, banks wishing to purchase foreign exchange (denominated in American dollars) were invited to bid on 3 to 5 percent of the amount made available by the Central Bank.

> The successful bids clear the amount of foreign exchange offered and it is the marginal bid that will determine the exchange rate of the naira to the dollar for that week. The marginal bid is the one that buys up the last amount of foreign exchange offered (*AfricAsia*, Jan. 1987: 24).

The banks were then mandated by the government to service 'legitimate' requests for foreign exchange to their customers—manufacturers wishing to import raw materials, parents wishing to send school fees to their children studying abroad etc. Other than some minor exceptions, such as obligations to international organizations, which were to be carried out at the CBN-determined first-tier rates, all foreign exchange transactions had to be conducted with SFEM funds. The decree that established SFEM was clear that banks should only honour foreign exchange requests that meet prescribed criteria. In order to prevent or depress non-contributive pursuits, the law also stipulated that the obtained funds must be used for the stated legitimate purposes. To discourage parallel markets, the decree prohibited any "unrestrained and general dealing in foreign currency."

On the first day of bidding, the naira fell to $0.20 cents. It averaged $0.25 during the next five bidding sessions (*AfricAsia*, Jan. 1987: 24). By the end of the third month of its operation, the value of the naira had plummeted by about 392 percent from its value on the 12th of June. Between January 1987 and March 1988, the depreciation rates stabilized relatively amidst outcries from elite circles and the injured fraction of the Organized Private Sector (OPS) that the naira was being thrown to the gallows. The latter was primarily the commercial wing of the OPS, led by the leaders and members of the MAN. Reportedly, though the general sentiment from MAN members and 'leftist' academics was that the naira had become under-valued, many economists (including academics) along with the leaders of NACCIMA agreed with the basic parameters of the government's exchange rates policy.[8]

According to MAN officials, however, it quickly became clear that the government's policy-makers were basically unsure of either the exchange rates policy framework or the acceptable degree of depreciation that should be allowed.[9] A top bank official argued that this was evidenced by the regime's frequent intervention under the table to influence the actual bank bids.[10] It appears more likely, however, that the Central Bank's unwillingness to allow the naira to fall freely stemmed largely from both the Babangida regime's sensitivity to widespread criticisms from the victimized wing of the elite class, the Nigerian Labour Congress (NLC), and other champions of the lower classes including many academics, and 'nationalists.' The regime's concern about the devaluation-driven inflationary pressure and the impact of the policy on the general standard of living also influenced its faltering implementation of the exchange rates policy. Nevertheless, by the

end of 1988, the rate of depreciation began to accelerate rapidly to stand at N7.90 to $1.00 in May 1990 (848 percent depreciation). The currency 'stabilized' at about N10.00 to $1.00 during the ensuing 18 months (*National Concord*, 1/8/1988: 16; *AR*, August 1992: 14).

At this point, MAN, the NLC, and others within the intellectual and elite circles such as Professor Sam Aluko began to flail away at the government for its handling of the economy (*African Business*, January 1992: 23).[11] The barrage of recriminations quickly reversed the putative general acceptance of the government's (and the IMF's) over-valuation claim. The critics now held, and widely expressed, the belief that the Central Bank had allowed the naira to become badly undervalued. By 1990, the criticisms appeared to have achieved popular currency with many 'ordinary' but interested Nigerian observers.[12] The experts, the argument went, had no knowledge of the naira's true value before tinkering with it: "if anything at all, it [devaluation] has been purely an educated guess" (*NC* 10/11/86: 3; *Newswatch*, 7/18/88: 32). The fact that there were definite and, purportedly, undeserving beneficiaries (particularly banking operations and perfidious officials) within the business community and government exacerbated matters and led to demands for corrective action. The largest newspaper in the country, the government-owned *Daily Times*, complained in an editorial that "too many ingenious kleptomaniacs are feeding fat on foreign exchange deals... they have to be removed from the scene." Between the official and illegal parallel markets, however, the exchange gap reversed the previous trend and again began widening badly. In fact, the gap grew so wide—up to N8.00—contributing to the IMF's decision in (October) 1991 to withhold its approval of the 15-month standby agreement signed in January of that year. (*Vanguard*, 1/7/93: 1; *AR*, August 1992: 14)

Given the tremendous amount of criticism and demands that the exchange rate declines be reversed, most observers were jolted by the government's decision in March of 1992 to impose a 41 percent currency devaluation. The Inter-Bank Foreign Exchange auction system was abolished, and the government began selling its available hard currency at the prevailing free-market rates. Although the action nearly wiped out the 60 percent gap with the illegal parallel market, it also resulted in a dramatic increase in domestic production costs. The immediate effect was that prices for food and other essential commodities shot up. Unfortunately, this coincided with gasoline shortages due to the closure of major refineries for overhaul. The resulting higher prices for available transport crippled many people. Riots erupted in

May of 1992 as frustrations conflated with anger about the devaluation-driven inflation and the devastating cumulative effects of eight years of austerity measures. One critic charged that the government was practicing 'economic razzmatazz' and blamed the regime's policies for generating a 'sleazy moral climate' (*African Concord*, 4/13/92: 26). Other critics immediately blamed the May events squarely on the government's economic policy. Indeed, Lasisi Osunde, the Secretary-General of the NLC was quite direct: "The riots were a direct consequence of the devaluation ... SAP has brought nothing but misery to ordinary Nigerians" (*AC* 4/13/92: 26; *AR*, August 1992: 14).

For its part, the government argued that the massive devaluation was necessary to protect the gains of SAP and to reinstate sanity in a financial system that had gone haywire due to the unprincipled activities of some bankers and businessmen who were undermining the regime's liberalization policies. Augustus Aikhomu, the number two man of the regime, bristled that the March devaluation was a `shock treatment... necessary in order not to continue to unwittingly encourage a society in which the rich continue to be richer and the poor poorer' (*AR*, August 1992: 14).

Despite the new policy, the illegal parallel market continued to thrive. In fact, in 1993 with the naira exchanging on the black market at more than N40.00 to one dollar, the gap between the official and unofficial markets was as high as N17.00. It stood at about N7.00 in early January 1993 when the illegal parallel market rate was about N26.60.[13] Ironically, the February 1993 plunge in the unofficial market stemmed directly from the Central Bank's decision on December 15, 1992 to suspend sale of foreign exchange to authorized dealers. The unprecedented action was taken in order to "complete investigation into suspected speculative purchases of foreign exchange by some authorized dealers which threaten the stability of the foreign exchange market" (*Guardian*, 1/8/93: 2).

The action, however, served to further destabilize the market as foreign exchange became less available, and as rumours of impending devaluation became rife. Due to the uncertainty, unofficial dealers began to ration or hoard their supplies of foreign exchange. The Central Bank was compelled to issue a statement on January 5, 1993 in an attempt to allay fears about the rumoured outstanding IMF request for a 40 percent depreciation that would bring the official rate to N25.00 for every U.S. dollar. The statement

acknowledged the IMF request but denied the Babangida regime's intention to carry it out.[14] Although the naira reportedly fell to as low as about N45.00 to one dollar around March, it recovered subsequently as the CBN reinstated its sales. In early June of 1993, the official rates stood at N25.00 to one dollar while the illegal market rate stood at about N32.00. Political developments in the country following the cancellation of the June 12 of 1993 presidential election and deteriorating economic conditions pushed the official exchange rate down to about N35.00 to $1, and the unofficial rate to about N50 to $1 by the end of 1993.

4.2 Elite Factions and the Devaluation 'Debate'

The principal political and military upheavals in Nigeria since independence have represented "fractional shifts within the local bourgeoisie and constitute stages in the evolution of social forces." Similarly, the Babangida regime's structural adjustment program reflected intra-elite struggle for factional dominance. Indeed, the regime's own emergence in 1985 was reflective of this process within the ruling military class. It was that faction's victory over a reluctant Buhari and Idiagbon faction that paved the road for Nigeria's first IMF stand-by agreement.

In proposing his threefold scheme for public policy techniques—distribution, redistribution, and regulation—Theodore J. Lowi theorized that the specific political processes and interest group relations associated with the categories develop as a result of the unique political dynamics involved in each (Lowi, 1964). He contends that whereas class divisions are reflected in legislative fights over redistributive policies, the battles over regulatory matters reflect divisions between various interest groups. This argument compelled one analyst to observe that even in those situations where we can hypothesize a defence for regulation, "political considerations, rather than policy justifications, may in fact be responsible for a significant portion of the existing regulatory apparatus" (Stone, 1982: 12-13).

This is not to say that deregulation is necessarily the better alternative in those situations where there is incontrovertible evidence of less than pristine motivations by policy-makers. Instead, it will be helpful for our purposes here to view Lowi's hypothesis as pointing to some of the peculiarities that may be involved in the Babangida government's struggle to reform the foreign exchange regime. Clearly, the old policy that was

being reformed served the interests (more or less) of many groups and individuals, especially the factions within the ruling elite class that had access to regulated foreign exchange. This group was made up of members of both MAN and NACCIMA, and ranking officials within the government and the military. However, significant beneficiaries also included members of the Nigerian upper and middle classes such as managers, accountants, doctors, lawyers, engineers and academics as well as others with the ability and desire to purchase plane tickets to Europe and North America. At any rate, the decision to change the policy, which actually subsidized the wealthy and other better offs in a highly non-contributive way, was bound to have a negative impact on the beneficiaries. Predictably, many of the aforementioned groups became some of the biggest critics of Babangida's attempt to improve the national productive competence through the exchange rates policy.

By their very nature, SAPs impose severe costs on the citizenry of the implementing country. Although much of those costs appear to be borne by middle and lower class groups, the ruling classes are not unaffected. The latter (dubbed the 'triangular elite alliance' by Terisa Turner and others) included (between January 1966 and October 1979) the military, the civil service and an assortment of business groupings (Turner, 1978: 166ff). William Graf (1988: 54) argued: "within this constellation, the military were, and remained, by far the politically dominant elite group." Although this elite configuration has remained largely intact, one must note some significant additions—retired military officers, civilian politicians, and academic elite groups. In essence, by 1990, the old triangular alliance had assumed a quadrangular shape consisting of the military (active and retired), the civil service, business groupings (including politicians), and academic elite elements. It is within these groups that one finds many of the debates pertaining to SAP.

In general, SAP implementation results in winners and losers not only between classes but also within the dominant elite formations. Although the exchange rates policy in Nigeria has always had profound class implications, the battle over the SAP-related policy shift was not fought along class lines *per se*, despite the important role played by the Nigerian Labour Congress. The most active actors were from the various factions within the ruling classes. They pushed their policy preferences for two rational reasons: to be among the winners or, at least, to reduce the extent of their losses. The resulting pressures on policy-makers were reflected in

the haphazard turns in policy decisions and implementation. One official who operated at the top level of two separate ministries found the pressures disturbing and stultifying but understandable:

> Government sometimes is forced to reverse decisions carefully reached by officials for political reasons. This is because it is important for government to be responsive to various interests in the country ... The problem is that officials [bureaucrats] are sometimes discouraged to work hard and objectively on some controversial issues because they know that someone will get the minister to alter the framework.[15]

When decisions, painstakingly taken by policy-makers, are subject to change because of elite pressures, one must wonder about the degree to which difficult and less deliberate decisions are ephemeral and reflective of the interest of elite and other pressure groups. Indeed, as Alan Stone argued in *Regulation and Its Alternatives*, there are strong reasons to believe that a lot of American economic regulations are products of political pressure from the affected interest groups. This perspective should inform our understanding of the logic and politics of the Babangida government's exchange rates policy.

To many observers, the most critical questions about the implementation of the Nigerian economic reform program centre on the government's devaluation policy. In that regard, the naira's realistic value was the central concern. Some elite observers, perhaps worried about the regime's penchant for demagoguery and the unexpected public rejection of an IMF agreement, cautioned against a general politicization of the devaluation policy. For instance, S. O. Ogundipe warned that monetary policy was beyond the understanding of the common man.

> In particular, the information required to manage foreign exchange is beyond the knowledge of the common man. His participation in such a matter might lead the government to take a decision that would in the end embarrass the government...[16]

The government's chief support came from industrialists who clamoured for immediate devaluation. Akin George, the national president of NACCIMA, insisted that it was "essential that the naira be devalued." The then chairman of UAC, Ernest Shonekan, argued that:

> The inflation-adjusted, trade-weighted exchange rate of the naira needs to be reduced by around 50 percent over a reasonably short time if a significant and substantial export drive is to be got underway (*Newswatch*, 6/30/1986: 33).

Other support for devaluation came from both professional economists and academics. Isaac Aluko-Oloku, the principal economist for United Bank for Africa and Simbo Banjoko, Director of the MBA program at the University of Lagos, were very vocal supporters. Banjoko pointed out that it was impossible for Nigeria to develop its local production base without devaluing. Arguing that over-valuation had transformed Nigeria into a dumping ground for imports "because of our belief that an over-valued naira is good business," Banjoko concluded that despite some initial distortions and dislocations in the economy, the overall impact of devaluation would be positive:

> ... nothing would be seen as inferior any more the moment Nigerians know that they cannot get foreign goods as cheaply as before. That, in turn, will provide a spur on local entrepreneurship (*Newswatch*, 6/30/1986: 34).

Many others who saw few, if any, positive results from a policy of devaluation countered such arguments. Bade Onimode and Dotun Phillips (professors of economics at the University of Ibadan) and economists such as A.O. Ereku (Nigerian Bank for Commerce and Industry) argued strongly that there was no legitimate rationale for the policy, particularly since measures such as the floating exchange rate policy had already been adopted and were effective in bringing the naira to par with its 'real' value. Ereku argued that the policy would have been "an attractive option if the goods we produce were wholly Nigerian or have at least a local content of, say, 80 percent" (*Newswatch*, 6/30/1986: 33). Pointing to the non-competitiveness of Nigerian goods in international markets, the opponents argued that devaluation would increase the cost of imported industrial raw materials, since Nigerian industries were dependent on other countries for 70 percent of their industrial raw material needs. They also maintained that with devaluation the amount of foreign exchange accruable to Nigeria would be unaffected given that crude oil sales were valued in dollars, not in naira. Citing the downward trend in the international commodity markets, they insisted that Nigeria's cash crops were unlikely to be stimulated by a devalued naira (*Newswatch*, 6/30/86: 33).

5. Summary and Conclusions

Interestingly, the debates often dealt only tangentially with the question of the opportunity costs attendant to resource transfers to foreign countries due to the national policy of subsidizing the pursuits of the upper and middle

classes. The economic policies, neglect, and corruption of the ruling elite had served to redirect the Nigerian economic structure away from food self-sufficiency and a diversified product base. By the late 1970s, for example, Nigeria was spending more than $1 billion every month on imported food. Most of the agricultural and mineral products by which the country had been one of the world's dominant producers and exporters—peanuts, palm oil, palm kernel, cocoa, rubber, tin, columbite, and hides and skins— were no longer contributing to foreign exchange earnings. Some were now being imported from neighbouring countries.[17] The demise of the agriculture sector had also occurred. Consequently, the country depended on petroleum resources to fund this ruling class policy.

Since the resources siphoned-off were largely deposited in European and North American banks, Nigeria was placed in the worst of all possible worlds. For one thing, the over-valuation of the naira meant that the diverted resources actually fetched more value than they should have been worth in foreign currency—thereby costing the state even more. Secondly, the resource diversion imposed tremendous and incalculable opportunity costs on the state, since little or no velocity (in internal naira circulation) was associated with the financial outlays while potential development gains were stultify. Thirdly, by starving the agricultural and rural sectors of capital, goods, funds for technical services, research, development and other support, the non-contributive foreign exchange policy served to impose severe structural damage on 'installed' productive capacity and competence.[18]

Fourthly, the decimation of the agricultural sector helped determine the parameters of the state's import substitution industrialization (ISI) policy by fostering and intensifying the high dependence on imported raw materials. The exchange strategy not only diverted resources away from contributive investments in various sectors, but also rendered the national economy extremely vulnerable to the vagaries of the external environment. One of the net effects of the exchange regime was that by (indefinitely) shielding new industries from competition it helped to institutionalize domestic industrial inefficiency and inept management. Finally, by focusing primarily on products favoured by or serving the needs of the upper and middle classes, the ISI strategy quickly made it possible for the ruling elites not only to ignore the needs of the rural sector but also to sharpen the gulf between social classes, and between the state and mass society.

In essence, the 'debate' over the new exchange rate policy largely ignored the cumulative, deleterious consequences of the old framework—particularly the massive diversion of resources. Most of the participants saw things primarily from their own narrow perspectives or ideological lenses, rather than through the perspective of the 'public'. The intra-class and inter-class struggles rapidly became evident.

Notes

1. The OPS is made up of Manufacturers' Association of Nigeria (MAN), Nigerian Association of Chambers of Commerce, Industry, Mining, and Agriculture (NACCIMA) and Nigerian Employers Consultative Council (NECA).
2. These notions were often expressed generally by businessmen (particularly, those that relied on foreign exchange purchases), bureaucrats (especially in the Finance and Petroleum ministries, and in the Finance and Political sections of the Presidency), journalists, professionals and academics.
3. Interview #15, *Newswatch*, January 7 1993, Ikeja.
4. Odozi acknowledged Rimmer's basic argument when he stated elsewhere that it is a `fact that our economic problems have deep fiscal roots' (*Guardian* 1/7/93: 15).
5. For instance, effective and honest bureaucrats and managers, an integrated and efficient industrial and manufacturing sector, an enabling domestic economic environment, competitive productionist logic etc.
6. An official of the Agriculture Office of the CBN ascribes a substantial part of the problem to the illegal activities and mismanagement of the managers of agriculture-based parastatal companies. Interview #1, Central Bank, January 11, 25 & 30, February 13, and March 23, 1990, Lagos Island.
7. SFEM was merged with the First-Tier on July 2 and became the Foreign Exchange Market and later the Inter-Bank Foreign Exchange Market.
8. Interview #2, Central Bank, February 1 and 7 1990, Lagos.
9. Interview #34, MAN, February 14 1990, Lagos.
10. Interview #39, First Bank of Nigeria, June 8 1990, Lagos.
11. MAN consistently criticized the government's handling of foreign exchange policy. It attributed the slow economic growth, rising inflation and unemployment, declining living standards, persistently low capacity utilization, weak aggregate domestic demand, and high cost of raw materials on government mismanagement of the economy. See any copy of Manufacturers Association of Nigeria, *MAN Half-Yearly Economic Review* between 1987 and 1992.
12. This feeling was expressed regularly by numerous Nigerians with whom I spoke between 1989 and 1994.
13. Figure provided by a black market operative at Balogun Street on Lagos Island. Interview #45, January 6 1993, Lagos
14. The assurances failed to stem the slide of the naira. Even if the dealers believed the government's position, the available supply of foreign exchange was far below the demand for it as CBN suspension of sales continued until March of 1993.
15. Interview #20, Ministry of Youth and Sports, March 8 1990, Victoria Island, Lagos.
16. The government organized a SFEM Enlightenment Campaign Committee to travel to every state of the Federation for the purpose of co-opting key elite groups (Comrade Issa Aremu, 1987: 11).
17. Interview #11, CBN (Forex Section), May 20 1990, Lagos.
18. This would include the exodus of able-bodied young people to the urban centres. Also, by discouraging farmers from long-term investment commitments to their land or labour or products that require years to mature—such as cocoa or rubber—the policy actually imposed severe structural damage to national productive capacity and competence.

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The Performance of Private Investment in the Changing Macroeconomic Policy Environment of Tanzania

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Abstract

This article examines trends in private capital formation in Tanzania in the changing policy environment of the period 1967-99. Its major argument is that the macroeconomic policy environment influences the investment decisions of private investors. Important variables seen to influence private investment are the rate of inflation, the exchange rate premium, openness and financial deepening. Uncertainty, captured by variations in the rate of inflation and the exchange rate premium, and country risk, measured by the foreign debt/GDP ratio, discourage private investment.

1. Introduction

Tanzania experienced an unprecedented and severe economic crisis, starting in the late 1970s and lasting generally for the whole period under discussion. This had its own lessons on the management of the economy, necessitating a critical re-examination of fundamental economic management principles. The crisis manifested itself in, among others, extensive and persistent macroeconomic imbalances, a widening saving-investment gap, unprecedented high rates of inflation, chronic balance of payments problems, a huge budget deficit, and a general slowdown in output growth (Ndulu, 1987). Agricultural output grew at an anaemic 2 percent per year, with industrial output falling by 15 percent while capacity utilization went down to less than 25 percent. In addition, there was a considerable deterioration in the country's transport system and other public services, such as telecommunications, water supply, education and health services (Mans, 1994). Responding like most other sub-Saharan African (SSA) countries, Tanzania embarked upon a reform process from the mid-1980s. These reforms were meant to reverse the trend and set the country on a course of sustainable growth. Conspicuous among the reforms has been the

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