CURRENCY RESTRUCTURING EXERCISE IN NIGERIA: OVERVIEW AND POTENTIAL IMPLICATIONS

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ABSTRACT

This paper seeks to examine the potential policy implications of the new currency restructuring exercise (CURE) on the Nigerian economy. The specific objective of this study is to review the composition, rationale and proposed benefits of currency restructuring policy of CBN. The study overviewed the key rationale of the new Project CURE, which was designed to reduce cost of printing small currency notes, to minimize dollarization of the Nigerian economy and impacted on the exchange rate policy of CBN that has not been effective particularly between 1998 and 2011. The findings of the study show that the key potential policy implications of the new currency restructuring exercise are to raise Currency in Circulation, Money Supply and consequently inflation rate. It also has the potential of creating foreign currency liquidity risk. The study recommends that there should be greater focus on stabilization of Naira and there should be harmonization of fiscal and monetary policies. The study concludes on a final note that there are more pressing issues to be addressed currently in Nigeria.

Keywords: Currency Restructuring, Nigeria, Potential Implications

1. INTRODUCTION

Over the years, it has been observed that government in most developing economies have redenominated their currencies on several occasions. Currency redenomination was seen as a means by which government attempt to reassert monetary sovereignty. In other words, if citizens lose confidence in the national currency, they may begin to use foreign currencies. This process is popularly referred to as 'dollarization'. The term currency restructuring or redenomination refers to either to a change in the number of zeros associated with a given currency, or it can apply to the introduction of a new currency. Currency redenomination, then, may come as part of a broad package of economic and political reforms, as were the cases in some countries.

For example, Afghanistan in October 2002; following years of decline in its currency value, a new *afghani* was introduced, with three zeros removed. This introduction was meant to herald, along with a series of other measures, the emergence of Afghanistan from years of civil conflict, and its movement toward modern nationhood. In 2005, Turkey slashed six zeroes from its currency. One minion of the old Turkish lira converted to one of the new Turkish lira (Economist, 2004). In 2008, Zimbabwe's slashed six zeroes from its currency (US Fed News Service, 2008). Also the introduction of the euro can be viewed either as the introduction of a new currency or a redenomination but it raised many redenomination issues.

Over time, Nigeria has experienced the introduction and circulation of different units of currency in response to two factors, the prevailing political and economic conditions. However, the former factor appears to have always weighed higher. For example, from the 1970s when the penchant for graduated higher currency denominations got on the increase in the country, the policy has always favoured a display of the portraits of the country past political leaders on the currencies so introduced. Perhaps, this has been done to appease their ethnic groupings (Chukwu, 2010). For example, by the 1880 ordinance, which introduced the first set of British Coins in the country, the 1-shilling Coin was the highest denomination1-shilling Coin. In 1913, the 2-shilling Coin became the highest denomination. This was so until 1919, when the 10-shilling Coin and £5 note were introduced into the economy. In each of these cases the currency units introduced were probably designed to meet the political and economic needs of the period (Chukwu, 2010). Since Nigeria's Independence in 1960, there have been different governments, constitutional reforms, change in economic policies and banking reforms, mainly directed at enhancing social welfare and achieving key macroeconomic objectives but Nigeria is still categorized as Less Developed Country. This calls to question the effectiveness of macroeconomic policies.

Moreover, Nigeria is a highly import-dependent nation which gradually erodes the strength of the naira relative to other currencies. In addition, the major function of central banks is to achieve price and exchange rate stability. However, Nigeria has not fared well in this regard. Once again, there arises the need to critically evaluate the new currency restructuring exercise of the Central Bank of Nigeria. Currency redenomination was seen as a means by which government attempt to reassert monetary sovereignty. In other words, if citizens lose confidence in the national currency, they may begin to use foreign currencies. This process is popularly referred to as 'dollarization'. Little wonder why the Central Bank of Nigeria initiated a new currency restructuring exercise, tagged "PROJECT CURE". Against this backdrop, the study attempts to examine the potential policy implications of CBN project on the Nigerian economy.

The main objectives of this paper are to review the composition, rationale and proposed benefits of currency restructuring policy of CBN, to assess the performance of similar policies in selected countries; to highlight the potential positive and negative implications of '*PROJECT CURE'* for the Nigerian economy; and to proffer valuable recommendations on the execution of '*PROJECT CURE'* in Nigeria. The paper is divided into seven sections; following this introduction is section 2 which focuses on brief review of relevant literature. Section 3 focused on the overview of currency restructuring in Nigeria, while brief evaluation of CBN exchange rate policy is described in section 4. Section 5 outlines the policy implications of 'project cure' in Nigeria and section 6 is the policy recommendations, while, section 7 concludes with a brief.

2. LITERATURE REVIEW

Several scholars have attempted to analyze the effect of currency redenomination and dollarization. However, only a few papers have presented a comprehensive evaluation of large-denomination notes and currency conversion, particularly in developing countries. Although, this study focuses on the potential implications of the recent currency restructuring exercise in Nigeria, it also provides an insight into redenomination effect in other selected countries. To understand the potential effects of 'PROJECTCURE', it is necessary to initially explain the term, '*dollarization'.*

2.1 Concept of Dollarization and Currency Redenomination

According to Kessy (2011), dollarization is a generic term used to characterize the use of any foreign currency that effectively serves as a replacement for national currency. The substitute currency is typically the currency of a major trading partner or an industrial power with a reputation of sound monetary policy. Notwithstanding, there exist three types of dollarization as noted by Meyer (2000).

First is ***official dollarization*** which means a complete replacement of the domestic currency by a foreign currency. In this case the chosen foreign currency becomes a legal tender, and plays the three fundamental roles of domestic currency namely, store of value, means of payment and unit of account. Examples of countries which have abandoned their local currency and adopt another currency include Panama and Ecuador.

Second is ***official semi dollarization*** which refers to a situation where both domestic and foreign currencies are freely used in the domestic economy – the foreign currency becomes a legal tender but the country also issues its own currency. This is for instance the case with Lesotho and Swaziland, where South African rand is officially accepted as legal tender alongside with domestic currencies. Most of countries that opt for official or semi-official dollarization are either small countries that rely on large neighboring economies for much of their income and their imports (Swaziland and Lesotho) or countries that suffer from macroeconomic mismanagement leading to hyper inflation rates (Ecuador and Zimbabwe). There is a consensus in the literature that both official dollarization and official semi-dollarization can succeed in fighting hyper inflation and bring about economic stabilization. For example, in Ecuador annual inflation rate declined from over 90 percent in 2000 when the country officially replaced its currency with the U.S. dollar, to a single digit in 2002. Similarly, following the adoption of South African Rand and the US dollar as a legal tender in Zimbabwe in January 2009, inflation rate declined from 231,150,889 percent in January 2008 to an annual average of 6.5 percent in 2009.

In case of full dollarization, where foreign currency replaces the domestic currency, authorities can no longer finance Government deficit through money printing (a major source of inflation) while for semi dollarization (as it is the case with currency board arrangement), the ability of the monetary authority to print more money is highly limited because an increase in the domestic money supply must be backed by foreign currency reserves. In this case, domestic monetary authorities can only increase money supply if they generate more foreign exchange by running a balance of payments surplus. With official dollarization, all seigniorage revenue accrues to the issuer of the currency, while official semi-dollarization arrangement allows monetary authorities to earn some seigniorage in addition to interest income on the foreign currency reserves that back the domestic currency issue.

The third form is ***unofficial dollarization*** which means that foreign currency is widely used in private transactions (as a unit of account, a medium of exchange and as a store of value) but the local currency remains the only legal tender. Many countries, including Nigeria, fall into this category. De Nicolo et al. (2005) further classifies unofficial dollarization based on the three functions of money: i) transaction dollarization (also known as currency substitution) which is the use of foreign currency for transaction purposes, ii) financial dollarization (also referred to as asset substitution) which consist of residents' holdings of financial assets or liabilities in foreign currency and iii) real dollarization which is the indexing of local prices and wages to the foreign currency.

Studies such as Leijonhufvud (2000) and Mas (1995), use the terms-currency reform and **"redenomination"** interchangeably. However, Bernholz (2005) used the former to refer to exchange rate-based liberalization while the latter was defined as the specific act of removing zeros from a currency. Currency redenomination, then, is a means by which governments can attempt to reverse this currency substituting behavior: if citizens are confident that the new 5000 naira note will hold its value, they may be willing to shift from using euros and dollars to using naira. While the act of dividing a currency's value by a factor of ten is somewhat symbolic, it also can help to convince citizens of a currency's worth (Mosley, 2003).

2.2 Empirical Literature on Currency Redenomination

There has been rich empirical literature analyzing the correlation between inflation and currency redenomination. Mosley (2005) employed a set of data for developing and transition nations, covering the 1960-2003 period. The study discovered that inflation is an important cause of redenomination. According to Mosley (2005), currency redenomination is also related to political variables such as: government time horizons, the governing party's ideology, the fractionalization of the government and legislature, and the degree of social heterogeneity.

Table 1: Inflationary Episodes and Currency Redenomination Outcomes

Country	Years & Annual Inflation Rates	Redenomination?
Brazil	1990 (2948%), 1991 (433%), 1992 (952%), 1993 (1928%), 1994 (2076%)	Yes (1993 and 1994)
Bulgaria	1991 (338%), 1996 (122%), 1997 (1058%)	Yes (1999)
Chile	1973 (362%), 1974 (505%), 1975 (375%), 1976 (212%)	Yes (1975)
Russia	1993 (875%), 1994 (308%), 1995 (197%)	Yes (1998)
Zimbabwe	2002 (140%), 2003 (estimated 1000%)	No
Sierra Leone	1987 (179%), 1990 (111%), 1991 (103%)	No
Ghana	1977 (116%), 1981 (117%), 1983 (123%)	No

Source: Inflation data from the World Bank*, World Development Indicators*

However, Mas (1995) suggested that large-denomination notes are the major reason for currency redenomination. During the 1960s in Argentina, one US dollar was equivalent to 1,100 (1962) to 3500 (1969) Argentine *pesos moneda nacional*. The 1970 redenomination addressed this issue, removing two zeros while creating the *peso ley*.

As regards the usage of foreign currencies relative to domestic currency, Erasmus et al (2009) assumed that the money multipliers of the two currencies are equal. The study concluded that the amount of US dollars circulating in Liberian economy in 2007 was nine times higher than domestic currency. Another method that has been used in the literature to estimate foreign currency in circulation is the denomination displacement method proposed by Feige et al. (2002). The thrust of this method is the hypothesis that foreign currency is typically used in large ticket transactions such as purchase of houses, automobiles and high value consumer durables.

Feige et.al (2002) argued that countries that are heavily dollarized will have domestic currency denomination structure that is skewed away from higher denomination domestic bills. This would occur as higher foreign currency denominations substitute for higher denominations of domestic currency. Foreign currency in circulation could therefore be estimated indirectly as a cumulative value of the reduction in higher denominations of domestic currency in circulation. Feige et al (2002) applied this method to the Croatian data but did not find evidence of denomination displacement.

Cross country studies such as Kessy (2011) conducted an empirical analysis into the determinants of financial dollarization in Tanzania and three other countries: Kenya, Burundi and Rwanda. For the period 2001 to 2009, the study discovered that financial dollarization was relatively high in Tanzania compared to other countries. In addition, Mosley (2005) suggested that currency redenomination was largely connected to political variables including government' time horizons, ideology of the ruling party, degree of social heterogeneity and fractionalization of legislature.

3. OVERVIEW OF CURRENCY RESTRUCTURING IN NIGERIA (*PROJECT CURE*)

Unlike the previous studies which emphasized 'dollarization' and 'currency redenomination', this study focuses on 'Project CURE' for two main reasons: First, Nigeria is yet to execute the peculiar components of the new exercise. Secondly, there have been previous restructuring programs in Nigeria. In other words, it necessitates the analysis of potential implications of this new CBN exercise.

Currency restructuring may be defined as that the entire process of ensuring an optimal currency structure in terms of efficiency, cost effectiveness and balanced mix of various denominations. It encompasses the design, storage, distribution, conversion and disposal of domestic currencies. Moreover, in line with international best practices, monetary authorities are expected to review their respective currencies at intervals of between five (5) and eight (8) years.

Table 2: Selected Periods of Currency Denominations in Nigeria

S/N	Denominations	Date of Restructuring	Years of Existence
1.	N100	December 1999	13
2.	N200	November 2000	12
3.	N500	April 2001	11
4.	N1,000	October 2005	7

In Nigeria, the last comprehensive review of the currency was carried out in 2005. It resulted in the introduction of the N20 polymer banknote followed by the varnishing of the N5, N10 and N50 paper banknotes in 2007. These lower denomination notes were eventually converted into polymer banknotes in 2009.

3.1 Justification for *Project CURE*

As a first step towards this *'Project CURE'* exercise, the CBN carried out a review of the existing currency series in 2010. According to CBN Conference Paper (2012), the following revelations and challenges were observed:

i. Public apathy towards the usage of the 50K, N1 and N2 coins, introduced in February, 2007.
ii. The varnished lower denomination banknotes failed to adequately meet expected longevity.
iii. Significant difficulties associated with the processing and destruction (briquetting) of the polymer banknotes.
iv. The tactile feature for the visually impaired on the polymer notes has not been as effective as desired.

In the light of the observed challenges, the CBN conducted several stakeholders' for a in 2011 on currency restructuring to gauge public and independent perspectives on the existing banknotes and coin series. The issues raised and the subsequent findings and decisions were summarised as follows:

Due to inflationary pressures, the CBN should coin lower denominations of currency up to N100. The relevant denominations in this category are N5, N10, N20, N50 and N100;

i. Need to encourage the usage of coins
ii. Enhancement of the quality of banknotes.
iii. Introduction of higher denomination banknotes to discourage **dollarization**
iv. Reduction of both the volume of banknotes and the overall cost of currency management.

3.2 Objectives of *Project CURE*

According to the recent CBN Press Briefing, the impending restructuring exercise is expected to achieve the following objectives:

i. Upgrading the design of the entire existing range of currency denominations in order to enhance the quality and integrity of the banknotes;
ii. Incorporating a more effective feature for the visually challenged.
iii. Introducing new security features on the redesigned banknotes. The intention here is to enable us take ownership and control of the new features on the series and eliminate payment of royalties on patented security features.
iv. Achieving an optimal currency structure that will ensure cost effectiveness and balanced mix and utilization of all the currency denominations.
v. Introducing new series of coins that would be generally acceptable for purposes of transaction
vi. Reducing the cost of production, distribution and disposal of banknotes by introducing a higher bill that would reduce the volume and cost of notes in circulation. The savings would be channeled to provide incentives for the usage and acceptance of coins.

In order to achieve the above objectives, the Press Briefing indicated that several entities have collaborated to redesign the new currency series. These include the *Currency Operations Department, Nigerian Security Printing and Minting Company (NSPM) Plc,* along with competent international consultants.

Hence, on the 28th of November, 2011, the CBN Board considered and approved the new currency series. It subsequently sought and on the 19th of December, 2011 obtained the approval of the Nigerian president. Under the new structure, the existing denominations of N50, N100, N200, N500 and N1,000 will be redesigned with added new security features. It is our pleasure to inform you that a new high currency denomination will also be introduced. It is the N5,000 note. In the same vein, the lower banknote denominations of N5, N10 and N20 will be coined. Consequently, the Naira currency structure will now be twelve (12); these are six (6) coins and six (6) banknote denominations. The details are as follows:

Table 3: Potential Currency Composition in Nigeria under *Project CURE*

Coins	***Currency Notes***
50 kobo	**N50**
N1	N100
N2	N200
N5	N500
N10	N1000
N20	**N5000**

3.3 Key Proposed Benefits of '*Project CURE'*

CBN also puts in place to ensure that the redesigned N50 and the new N5,000 banknotes should be launched early in 2013.

i. It has been argued that the introduction of a higher denomination banknote could exert inflationary pressures in the economy. 'Inflation in Nigeria is a monetary phenomenon'.
ii. Secondly, in some countries such as Singapore, Germany and Japan the highest denominations are 10,000 SGD, €500 and Yen10,000 respectively. These denominations have relatively high dollar equivalent. However, the levels of inflation were low at 2.8, 1.1, and -0.7 as at 2010.

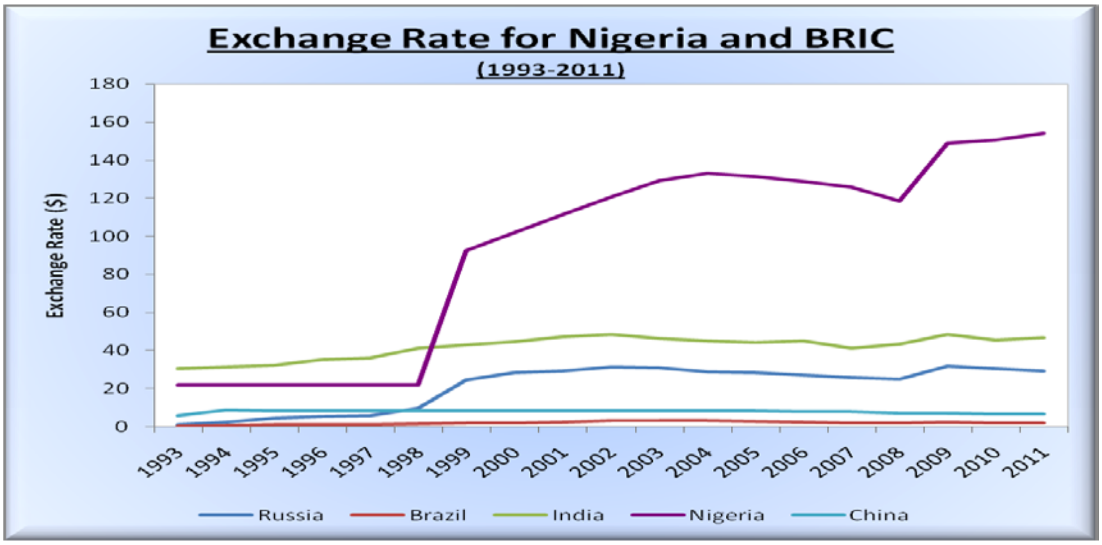
iii. Furthermore, it is believed that the introduction of a higher bill would complement the Bank's cash less policy as it would substantially reduce the volume of Currency-in Circulation particularly in the long term.

3.4 Other Relevant Stakeholders for *Project CURE*
In addition to the aforementioned stakeholds the following stakeholders also have significant roles to perform in this 'restructuring exercise'. They include:

i. Deposit Money Banks (DMBs)
ii. Specific Ministries, Departments and Agencies (MDAs)
iii. Road transport workers
iv. Market operators
v. Small businesses
vi. Supermarkets
vii. Vendors.

4. BRIEF EVALUATION OF CBN EXCHANGE RATE POLICY

The Central Bank of Nigeria (CBN) as well as other central banks (e.g. US Federal Reserve) is charged with the responsibility of ensuring stability in general price level and exchange rate. However, this study evaluates the exchange rate policy of CBN mainly because the *Project CURES'* was developed to prevent dollarization in the Nigerian economy.



From the graph above, the dollar/naira exchange rate is greater than that of the BRICs (Brazil, Russia, India and China) for 12 years (1998-2011). However, during the period between 1993 and 1998, Indian rupee versus dollar exchange rate exceeded that of Nigerian official exchange rate. In other words, Nigerian naira largely experienced depreciation and devaluation relative to US dollar in the selected years.

The above findings are not surprising as Nigeria is a highly import-dependent economy, despite the abundance of resources in Nigeria. Moreover, the United States accounts for the largest buyer of Nigeria's exports. Hence, demand for foreign currency compared to the naira continues to edge upwards. Thus, the observed upbeat trend in N/$ exchange rate raises doubts as regards the effectiveness of CBN exchange rate policies.

5. POLICY IMPLICATIONS OF 'PROJECT CURE' IN NIGERIA

Although, this new currency restructuring exercise is yet to be implemented in Nigeria, the following includes the potential impacts of '*Project CURE'* on the Nigerian economy.

i. As part of the project, the N5000 note has the advantage of reducing currency management cost in line with the cashless policy.
ii. However, the introduction of N5000 note and conversion of some existing notes to coins, could suffer lack of patronage and rejection. The rejection of such coins is on account of their low purchasing power.
iii. Although, the CBN highlighted the cost savings' benefit of the project, this does not imply that all costs accruing from the projects have been estimated. An example is the cost of public acceptance.
iv. Economic Implication: Despite the assurance of the CBN governor that the exercise will not cause inflation and that money supply will not increase, this study can prove the potential inflationary consequence of '*Project CURE':*
   M1 = CC + DD, where M1: narrow money supply; CC: currency in circulation and DD: demand deposits.
   As more N5000 notes are introduced, Currency in Circulation (CC) rises, thereby causing the Narrow Money Supply (M1) to escalate. This will promote expected inflation within the economy on one hand and positioning the Nigeria currency as worthless and without real economic value thus promoting movement in the supply and demand for dollars by making people now believes that the dollar is stronger. Also due to possible reluctance to hold coins, most traders are likely to charge higher prices and consequently cause inflation.
v. Political Implication: The introduction of large-denominated notes especially in a country like Nigeria encourages huge spending habits by politicians. That is the major issues identified here include the issues of the promotion of corruption and money laundering within and among the political class/political elite. It is believed that the introduction of higher denomination currency will only help worsen the rate of political corruption.
vi. Policy Conflict: Another key implication of the new currency restructuring exercise is to make monetary policy less effective especially when other monetary policy instruments are currently contractionary in nature. Also for a central bank that is currently promoting a cashless policy initiative, an effort to on the other hand introduce higher currency denomination into the Nigerian economy system is viewed as a policy conflict
vii. Since one of the key objectives of *Project CURE* is to discourage dollarization, this could create liquidity risk emanating from banks' inability to meet foreign currency obligations. Policies aimed at mitigating the impact of foreign currency liquidity risks are common in other dollarized countries, and have in most cases taken a form of higher reserve requirement. For example, Galindo and Leiderman (2005) show that in Bolivia, all foreign currency deposits have a 10 percent reserve requirement while fixed-term domestic currency deposits have zero reserve requirements.
viii. The new *Project CURE* may not result in de-dollarization of the Nigerian economy as long as Nigeria relies heavily on importation of almost all commodities.
ix. Social and Societal Implication: high currency denomination will increase the level insecurity in terms of the security risk involved in the movement of such denomination.

6. POLICY RECOMMENDATIONS

As a result of the numerous negative implications of the Project CURE as examined earlier, the following includes valuable recommendations for policy makers in Nigeria.

i. Enhance accessibility of funds to the real sector: Despite the huge amount of bank charges and the claimed reduction in cash handling costs, most banks cost savings have not trickled down to the real sector. Hence, the CBN should enforce banks to use certain percentage of their funds to finance the real sector.
ii. Consideration for currency redenomination: To aid the cashless policy in Nigeria, the monetary authorities could review the possibilities of two-decimal point currency redenomination. For example, the CBN replaces the N1000 note with N10. This would give added value and make 'kobo coins' once again desirable.

iii. Development of sound monetary policy model: It has been observed that most CBN governors engage in 'trial and error' techniques to achieve its primary goal of price stability. Hence, to achieve single-digit inflation rate, the Central Bank should initially evaluate proposed measures and employ sound monetary policy models.
iv. Harmonization of monetary and fiscal policies: For ultimate attainment of developmental goals, both the Central Bank of Nigeria and government (all the three tiers) should work hand-in-hand. For instance, if government pursues expansionary fiscal policy and CBN pursues contractionary monetary policy, inflation rate might remain at high levels.
v. Increased exports of domestically manufactured goods and services: As a highly import-dependent nation, Nigeria should improve the production and exports of manufactured goods. This would reduce the incidence of dollarization rather than usage of 'large-denominated' notes.
vi. Increased consultation with key stakeholders: Although, the Central Bank of Nigeria is the apex bank, it ought to consult with key stakeholders before making policy decisions.
vii. Greater focus on Naira value stabilization: The CBN should focus on stabilizing the value of the naira locally and internationally. It is so sad that, Nigeria engages in frequent currency devaluation.

7. CONCLUSION

As stated at the outset, this paper is aimed to review the potential impact of higher denomination of the currency on the Nigerian economy. Though currency restructuring policy is not peculiar to Nigeria only that many countries in the world had in one time or the other experimented with this instrument of monetary policy with varied and divergent outcomes and experience. However, in Nigeria it could certainly be seen that this policy will have more of negative than positive effects on the Nigerian economy. This is due peculiarity of the Nigerian situation in terms of its corruptive nature and its volatility of the political atmosphere and security challenges.

Finally, the craze for higher currency denominations may not solve Nigeria's economic problems. The problem may be solved through a rejuvenated productive base of the economy. This study believes that there are more pressing issues to be addressed in the long-run. Hence, the PROJECT CURE is unnecessary and irrelevant to the current economic state of Nigeria. Nevertheless, the aforementioned policy implications and recommendations should be considered.

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