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CURRENCY DEVALUATION AND POVERTY IN NIGERIA

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Abstract

This study examined the link between currency devaluation and poverty in Nigeria. The theory of devaluation has been supported with justification due to the benefit obtainable in currency devaluation, while its' critics has dwell on its' disadvantages to the developing countries. Data from 1981 to 2014 is used for estimation are tested with the autoregressive distributed lag model. The results of the autoregressive distributed lag model showed that devaluation increase poverty in the country. In addition, inflation and trade was found to increase poverty when devaluation is done. Furthermore, this study suggested that production of agricultural goods and electricity are key factors that should be present in order to cushion the effect of devaluation and reduce poverty in the country.

Index Terms—Currency devaluation, poverty, inflation, trade, income growth, bounds test approach

I. INTRODUCTION

Poverty remains a dilemma over the years in Nigeria, and it is worrisome when considering huge resources that have been committed to its reduction. Hence, economic report still shows that poverty rate is alarming in the country (World Bank, 2014). For instance, the report of MDG (2013) showed that the country has not been able to halve the number of population that lives under 1 USD a day, and the effort to reduce poverty prevalence of 69.0% in 2010 to 21.40% by 2015 as a target was not achieved. The achievement of Vision 20:2020 where Nigeria is expected to be among the top 20 countries in the world may become a mirage if poverty is not reduced. Also, previous studies in the literature have said that poverty existence in Nigeria is unabated,

rather than reducing, it has increased persistently. For example, Obadan (2002) and Umukoro (2013) emphasized the various means that has been used to reduce poverty in Nigeria; Canagarajah and Thomas (2002), Aigbokhan (2008) dwells more on growth of the economy in respect of poverty; Anyanwu (2012) identified some socio determinants for poverty in Nigeria; and Holmes et al., (2012) provided details of social protection in Nigeria. Fidelis (2014) focused on poverty programs in Nigeria as regard currency devaluation but the study is limited in scope and did not consider macroeconomic data. Nonetheless, the journey to reduce poverty in Nigeria by the government seems endless, and likewise the debate on what factors that causes poverty in the country.

Moreover, few studies have made attempt to link currency devaluation to poverty. While some studies have supported the idea of devaluation due to the gains it brings, others have shown contrary evidence because it has not help developing countries. Also, the proponents of devaluation have argued that devaluation encourages more foreign capital inflow and buyers of locally made products which in turn leads to more revenue (Alexander, 1952). In contrast, devaluation is trailed with increase in prices which later affect the wage price (Copper, 1971). More so, Deepa and Gireeshkumar (2014) posited that devaluation makes outflows of capital a continuous one and increased deficit in current account but, the study provided no empirical testing. Also, studies have shown that devaluation is an evil that transit developing countries into the ocean of poverty. Devaluation encourages widespread poverty through income distribution, unemployment and poor poverty programmes in developing countries (Ghani, 1984; Casero & Seshan, 2006; Pauw et al., 2013 and Fidelis, 2014). Meanwhile, studies have not shown how devaluation affects poverty in Nigeria using macroeconomic data. Therefore, this study filled the gap to examine the extent of how devaluation has encouraged poverty which has become a cancer on the Nigerian economy.

II. LITERATURE REVIEW

2.1 Theory on devaluation

The absorption approach to devaluation theory by Alexander (1952) hinged on how trade balance effect could occurred when devaluation of currency took place through the relationship between real expenditure and real income which would be shaped by the price levels rather than the analysis of demand and supply. However, he emphasised that the trade balance effect would depend on the following presumptions:

(i) the elasticity of foreign demand for the country's exports;
(ii) the elasticity of domestic supply of export goods;
(iii) the elasticity of domestic demand for imports; and
(iv) the elasticity of foreign supply of imports.

The first and second presumptions rest on how devaluation would affects the price levels and the country's export. That is, the price level would reduce which could attract more foreign demand of the country's export. While, at the import side, the third and fourth presumptions would hold since the country wish to reduce level of import. That is, devaluation would encourage more reduction of imports demand that may affect the world price of goods

imported. Nevertheless, he argued that when a country is having idle resources the income of devaluing country may be affected because devaluation would cause more production and employment to take place. By this, balance of payment would be more favourable on the fact that the country's change in income is less than unity. Besides, this would depend on the possibility of absorption of the devaluating country and other countries. The devaluating country must be able to increase the output of goods with no increase of price of the goods. More so, other countries should be able to increase their level of demand for the devaluating country's goods.

Moreover, the pure theory of devaluation as explained by Kuska (1972) assumed that there are two economy that comprised the Inland and Outland. The Inland is the country that has its currency devalued while the Outland is the rest of the world. He maintained that prices are flexible which recognises money stocks; no changes in tastes overtime; there is one of period-horizon for all economic agents; durable goods are traded in fiat money; individuals are not in possession of any other currency apart from the local currency and a regulatory body to keep the fixed exchange rates. However, He concluded that in the long run, the international reserves valued in Inland currency will be increased; monetary variables in the Inland will have increase in their prices less than the increase in rate of exchange; monetary variables prices in Outland would reduce less than the level of devaluation; and lastly, real variables were left unchanged.

However, the implication of these approaches on theory of devaluation particularly, on the developing economies like Nigeria is that prices of goods and services will be increased. The increased in the prices would lead to inflation which may worsen the low income earners purchasing power. Moreover, the gain from export would purchase less of foreign goods due to the weakness of currency. This weakness of currency would increase more outflows of capital when foreign goods and services are being demanded locally. The low level of capital in developing countries would affects the rate of production that may lead to low income and result to poverty. However, most of the assumptions in devaluation theory were less relevant to developing nations than to the developed countries (Ghani, 1984). That is, developing nations are more characterised with labour market imperfections that may not be responsive to factor price due to high urban employment and poverty and more peasant farmers in the rural sector.

2.2 Devaluation and Poverty

In justifying the role effects of devaluation on the economy, Deepa and Gireeshkumar (2014) claimed that Indian economy has been affected by Rupee depreciation positively and negatively. That is, the depreciation has been able to drive-up the revenue of Information Technology and some manufacturing in textiles and pharmaceutical. But majorly, buying and travelling related to import goods are more expensive which has caused fiscal deficit to be increased. More so, it lead to an increase in cost of borrowing in the industry sector which has made this sector to lay off workers thereby increasing the unemployment in India. In addition, the benefit in export is unlikely to offset the increase in inflation and cost of borrowing thereby making borrowers to suffer more. Closely, Fidelis (2014) found that the devaluation of currency

based on respondents in Edo State, Nigeria has made the poverty reduction programmes to be ineffective and instead the poor have suffered more. This is because the financial assistance provided to support poverty reduction programmes was weaken by devaluation. In addition, the study noted that the objective of achieving economic growth through this means (devaluation) was defeated. Meanwhile Casero and Seshan (2006) showed that devaluation in Djibouti actually boosted revenue in the country at the short term because the changes in exchange rate was more than the price level which made the saving level to be increased. More so, household with low and middle income were put below the poverty line and making those low income earners to be more extremely worse. Similarly Pauw et al., (2013) asserted that poverty at household level in Malawi, was affected by devaluation especially through the channels of income and price. The production expansion enables income through employment to increase with a falling price which is beneficial to the consumers at the expense of the farmers. However, they provided that in the long run devaluation especially under fixed exchange rate would worsen the income inequalities of household if the premium increases.

2.3 Devaluation in Nigeria

The Nigeria currency (₦) was first devalued in 1973 by 10% in view of the devaluation of US Dollar ($) with the hope to have a strong foreign exchange reserves and better trade balance (Ike, 1984). More so, the devaluation was acclaimed that the sales of country oil product would improve to have more favourable trade. However, the external reserves increased from ₦389 million Naira in 1973 to ₦3,398 million Naira in 1974, a year after the first devaluation. Besides, in the subsequence years the external reserves decreased at -2.5% in 1975 and -18% in 1977 (Ike, 1984). Thereafter, the foreign exchange rates adopted failed to achieve the objectives. For instance, the official exchange rates against US$ stood at ₦0.61, ₦0.72 and ₦0.89 in 1981, 1983 and 1985 respectively in the pre-Structural Adjustment Period (SAP) period. In the pre SAP period, fixed exchange and stabilisation policy could not produce a desirable achievement of trade balance for the country. Moreover, the SAP period introduced in 1986 with the objective of realisation exchange rate to reduce the over valuation of Naira with flexible exchange system under the second-tier Foreign Exchange Market (Odili, 2014). But, the introduction of SAP in the country since 1986 has shown a continually reduction in the forte of Naira currency against US Dollar and other major currencies (Imimole & Enoma, 2011). That is, the exchange rates from the SAP period up till 2013 keeps deteriorating against the Naira as shown in figure 1 below.

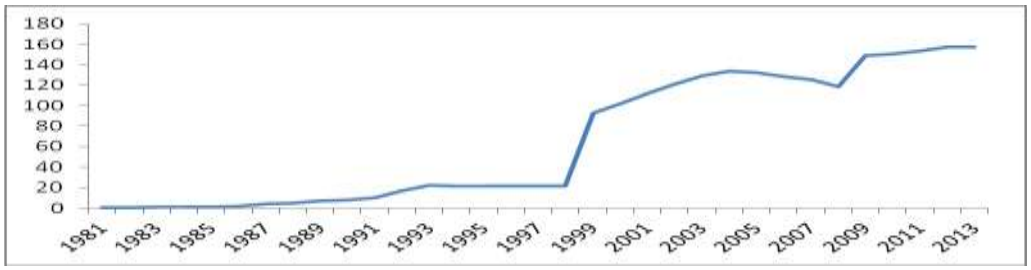

Figure 1: The official exchange rates from 1981 to 2013
Sources: Central Bank of Nigeria Statistical Bulletin, 2013.

The concern of currency devaluation of Naira as noted by Akinlo and Odusola (2003) is that, inflation is being increased and reduced the hope to increase output level. Also, Abioye and Asu (2014) asserted that expectation of major rise in prices of goods and services usually followed devaluation. For instance, the devaluation in 2014 shows that there was immediate increased of Monetary Policy Rate from 12 to 13 per cent (Abioye & Asu, 2014). More so, the volatility that devaluation cause in the exchange rate has translated a major impact on the increasing of inflation in the country (Bakare, 2014). That is, the currency devaluation of Naira has contributed to inflationary trends in Nigeria (Imimole & Enoma, 2011). Besides, Ogundipe et al., (2013) found that devaluation is having a negative effect on trade balance in Nigeria. The critical issue here is that devaluation is expected to improve the welfare of the citizens but its impact at various time in the country was more felt by the poor negatively. Nevertheless, devaluation leads to increase of prices goods and services which reduce the purchasing power of the population.

2.4 Poverty in Nigeria

In the period under reviewed between 1980 and 2014, poverty rates increased from 27.2% in 1980 to 46.3% in 1985 and by 1996, it increases to 65.6% which later shoot up to 69% in 2010 and 72.0 in 2012 (CBN, 2012). More so, the dimensions of poverty in Nigeria further showed that poverty in the urban areas are more intensified but not like the poverty in the rural areas. For instance, the urban poverty rose from 17.2% in 1980 to 73.2% in 2010 while the rural poverty increased from 28.3% in 1980 to 73.2% in 2010 (NBS, 2010). Also, the spread and trend of poverty in Nigeria is highlighted in Table 1. However, the increased in poverty incidence in Nigeria was addressed with various measures as highlighted in Obadan (2002) but these measures seems not adequate (Umukoro, 2013). This is because the social protection available were weak in getting the huge number of population out of poverty; that is, halving number of people living below US$ 1 a day and reduction of poverty to 21.40% proved difficulty (MDG Report, 2013). Besides, the MDG Report (2013) indicates that poverty still needs to be reduced by 41.20%. Nevertheless, Aigbokhan (2008) concluded that poverty lowers growth in an economy as poor people would have low access to better employment and credit facilities. More so, the main aim of devaluation was to boost economic growth through more foreign capital and discouragement of importation but it is obvious that such aim may be threaten in an economy with prevalence of poverty. This is due to fact that inflation will always trail devaluation as shown in Bakare (2014), Abioye and Asu (2014). Thus, the prevalence of poverty in Nigeria may continue to encourage poor economic development but how devaluation has contributed to it remains unravel.

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TABLE 1: Spread and Trend in Poverty Levels (%) in Nigeria

Years	1980	1985	1992	1996	2004	2010
Levels						
NATIONAL	27.2	46.3	42.7	65.6	54.4	69
Urban	17.2	37.8	37.5	58.2	43.2	61.8
Rural	28.3	51.4	46	69.3	63.3	73.2
ZONE						
South South	13.2	45.7	40.8	58.2	35.1	63.8
South East	12.9	30.4	41	53.5	26.7	67
South West	13.4	38.6	43.1	60.9	43	49.8
North Central	32.2	50.8	46	64.7	67	67.5
North East	35.6	54.9	54	70.1	72.2	76.3
North West	37.7	52.1	36.5	77.2	71.2	77.7

Source: National Bureau of Statistics 2010.

III. METHODOLOGY

This study approaches the link between devaluation and poverty in Nigeria by using time series data from 1981 to 2014. Data on all the variables are obtained from the World Bank Indicator (2016). Also, following Uddin, Shahbaz, Arouri, and Teulon, (2014), this study used household per capita con consumption expenditure to capture poverty (POV_t). Devaluation (EXR_t) is measured using the official exchange rate of Naira to US Dollar and based on the theory of devaluation, the growth rate of inflation (INF_t) and trade as a percentage of GDP (TRD_t)were included into the model. Also, the inclusion of real GDP per capita growth was based on the model, and we controlled for urbanisation (URB_t) because urban dwellers are more involve in the foreign exchange market than the rural dwellers in Nigeria. In addition, this study employed with slight modification the poverty model in Gupta, Pattillo and Wagh (2009). The model used in this study is as presented in equation 1. In equation 1, 1, $\gamma 0$, $\gamma 1$, $\gamma 2$, $\gamma 3$, $\gamma 4$, and $\gamma 5$ are parameters while ε_t is the white noise. Due to the proxy used for poverty, this study expected $\gamma 1$, $\gamma 2$, $\gamma 3$, $\gamma 4$ and $\gamma 5$ to have positive signs on household per capita consumption expenditure in order to reduce poverty.

$$lnPOV_t = \gamma_0 + \gamma_1 GRPC_t + \gamma_2 lnEXR_t + \gamma_3 INF_t + \gamma_4 lnTRD_t + \gamma_5 lnURB_t + \varepsilon_t \quad (1)$$

The unit roots test is carried to ensure stationarity in the variables. The test is to avoid any serial correlation that could make coefficients ineffective which usually led to spurious results in regression. Thus, the Augmented Dickey-Fuller (ADF) unit roots test is employed to test whether variables are stationary or not. Also, the lag for each of the variables are determined by automatic based on Schwartz Bayesian criterion with maximum lag9. Besides, the null hypothesis is that the series has a unit root and the rejection of this null hypothesis is that series

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is not having a unit root, that is series is stationary based on the MacKinnon (1996) as specified in E-view 9.5. The results of the unit roots test is presented in Table 2.

Table 2: Unit Roots Tests

	Augmented Dickey-Fuller (ADF)		Decisions
Variables	Level	1ST Difference	
	Intercept and trend	Intercept and trend	
lnPOV	-3.118	-8.051***	I(1)
	-5.320***	-8.435***	I(0)
lnEXR	-1.789	-4.282***	I(1)
INF	-3.702**	-5.205***	I(0)
lnTRD	0.109	-5.536***	I(1)
lnURB	-1.613	-5.245***	I(1)

NOTE: the figures reported are t-ratio and those figures in parenthesis show the P-values of MacKinnon (1996) one-sided at various level of significance. The Asterisks (***) is at 1%; (**) is at 5% and (*) is at 10%.

Based on the result of the unit roots test that indicated mixed series of I(0) and I(10), this study use the proposed autoregressive-distributed lag model (ARDL) by Pesaran, Smith and Shin (2001) to carry out the estimation. In addition, the sampled size nature of this study cannot be influenced negatively while using ARDL (Nayaran, 2005). This is because ARDL takes care of endogeneity problem in socioeconomic variables due to the dynamics of the lagged transformation in the ARDL tool. Also, the optimal lag length is determined by Akaike Information Criterion because it yield better results for small sampled size (Liew, 2004). Consequently, the dynamic lag length specified is ARDL Model (2, 2, 2, 1, 0, 1). Moreover, F-test statistic in the bounds test is used to determine the cointegration in the long-run. That is, the joint significance of the coefficients was tested with F-statistic at one period of lag as shown in equation 2. The null hypothesis of no cointegration is that H0: $\gamma 1$ to $\gamma 6 = 0$ while the alternate is H1 : Where at least one of the $\gamma 1$ to $\gamma 6 \neq 0$ (implies cointegration). Thus, the results of the bounds test/cointegration test is presented in Table 3.

$$\Delta lnPOV_t = \gamma_0 + \gamma_1 lnPOV_{t-1} + \gamma_2 GRPC_{t-1} + \gamma_3 lnEXR_{t-1} + \gamma_4 INF_{t-1} + \gamma_5 lnTRD_{t-1} + \gamma_6 lnURB_{t-1} + \sum_{i=1}^{p} \tau_1 \Delta lnPOV_{t-i} + \sum_{i=0}^{p} \tau_2 \Delta GRPC_{t-i} + \sum_{i=0}^{p} \tau_3 \Delta lnEXR_{t-i} + \sum_{i=0}^{p} \tau_4 \Delta lnINF_{t-i} + \sum_{i=0}^{p} \tau_5 \Delta lnTRD_{t-i} + \sum_{i=0}^{p} \tau_6 \Delta lnURB_{t-i} + \varepsilon_t \quad \ldots\ldots (2)$$

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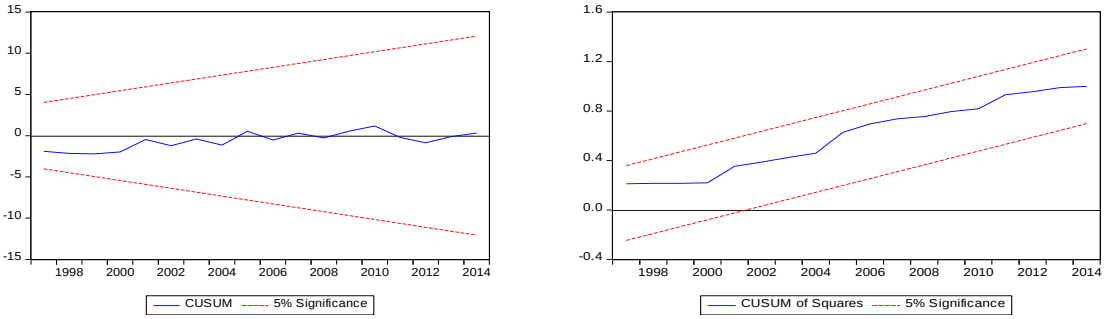
IV. RESULTS

The results of the bounds test showed that the F-statistic value is above the critical values at 1% level of significance. Following the result of bounds test, the long-run, short-run and error correction model are determined, and results are indicated in Table 3. In the long-run estimates, devaluation affects household per capita consumption expenditure negatively at 5% level of significance. This shows that 1% increase in devaluation increases poverty by 0.42%. This result supports Fidelis (2014) who concluded that devaluation reduced the strength of financial assistance in poverty reduction programmes in Nigeria. Also, inflation affects poverty through reduction in household per capita consumption expenditure at 1% level of significance. That is, an increase of 1% in inflation would cause poverty to rise by 0.016%. In addition, trade negatively affects household per capita consumption expenditure at 10% level of significance. This connotes that 1% increase in trade during devaluation time would increase poverty by 0.25%. Moreover, the short-run results showed that income growth and devaluation affects household per capita consumption expenditure positively at 10% level of significance. That is, improvement in income growth by 1% would reduce poverty by 0.003%, and 1% increase in devaluation would reduce poverty by 0.069%. In addition, inflation and trade affects poverty positively at 1% and 10% level of significance respectively. This is because inflation and trade reduce household per capita consumption expenditure. Thus, the error correction model validated the existence of stable relationship in the model in the long-run (Bannerjee, Dolado & Mestre, 1998) based on the negative sign. The error correction model showed the poverty model can be restored back to equilibrium in respect of deviation that occurred in the model. That is, the poverty model has an adequate feedback mechanism to adjust itself to equilibrium by 0.46% over the following year.

Moreover, the model is subjected to diagnostic tests in order to validate long-run coefficients. These tests are Jarque-Bera test for normality χ^2_N, Ramsey's RESET test for function form(χ^2_{FF}), Breusch-Godfrey test for serial correlation(χ^2_{SC}), Breusch-Pagan-Godfrey Heteroskedasticity Test (χ^2_H) and the structural stability test of cumulative sum of recursive residuals (CUSUM) and cumulative sum of recursive residuals squares (CUSUMSQ) as presented in Table 3 and Figure 2 respectively. Also, the result of these diagnostic tests are passed at 5% level of significance. That is, the result of long-run relationship presented in this study are freed from the problems of improper distribution, omitted variables, serial correlation, homoscedasticity and instability.



a. b.

Figure 2: Stability test for the poverty model

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Table 3: Estimates of the poverty model using ARDL Model (2, 2, 2, 1, 0, 1)

	Long-run Estimates			Short-run Estimates	
Variables	Coefficients	t-statistics	Variables	Coefficients	t-statistics
	-0.004	-0.350		-0.453	-4.703
$lnEXR$	-0.426	-2.786**	$\Delta GRPC$	0.003	1.944*
INF	-0.016	-4.531***	$\Delta GRPC(-1)$	0.006	4.120
$lnTRD$	-0.250	-1.763*	$\Delta lnEXR$	0.069	1.833*
$lnURB$	-0.354	-0.928	$\Delta lnEXR(-1)$	0.271	5.328
	16.029	11.289		-0.004	-4.735***
			$\Delta lnTRD$	-0.121	-2.076*
			$\Delta lnURB$	0.354	1.468
			$ECM(-1)$	-0.466	-7.961***

	Diagnostics Tests			Bounds Test	
Tests	Value	Prob	Test statistic	Value	K
χ^2_N	0.591	0.744	F-statistic	6.059***	5
χ^2_{FF}	0.739	0.401	Critical value bounds		
χ^2_{SC}	0.431	0.511	Significance	I(0)	I(1)
χ^2_H	14.800	0.320	10%	2.08	3.00
$Adj\,R^2$	0.872		5%	2.39	3.38
AIC	-1.825		1%	3.06	4.15
BIC	-1.183				
HQ	-1.612				

Note: the t-statistics are failed to be rejected at 1% (***); 5% (**) and 10% (*) appropriately. Also, χ^2_N, χ^2_{FF}, χ^2_{SC} and χ^2_H are significant at 5%.

V. CONCLUSION

The study examined the link between devaluation and poverty with consideration of devaluation theory, the study found that devaluation is harmful to the country because the result in this study showed that devaluation of currency encouraged poverty in the country. The performance in trading activities when devaluation took place increased poverty because devaluation weakens the home currency as the case of Naira in Nigeria. The effect is that cost of

living increased and the purchasing power reduced. While the cost of living increased, the poor in the country suffer more because their low income purchase fewer goods when compared to era before devaluation took place. Also, the income growth reduce poverty in the short-run, and not significant in determining poverty in the long-run. The poor performance of income in the economy is due to high cost of living and poor trading activities in the country both in the short-run and long-run. However, in resolving the problems of devaluation the policy makers should identify absence of foreign factors in Nigeria that can influence the demand for foreign currency by Nigerians. For instance, decay infrastructures in the country should be made functioning. This is because presence of sound infrastructures in forms of transportation and electricity would promote trade and encourage local production. Thus, the promotion of trade and production would induce viable income-employment generation that can counter the effect of inflation which comes with currency devaluation.

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