NAIRA REDESIGN POLICY: CAUGHT IN THE WEB

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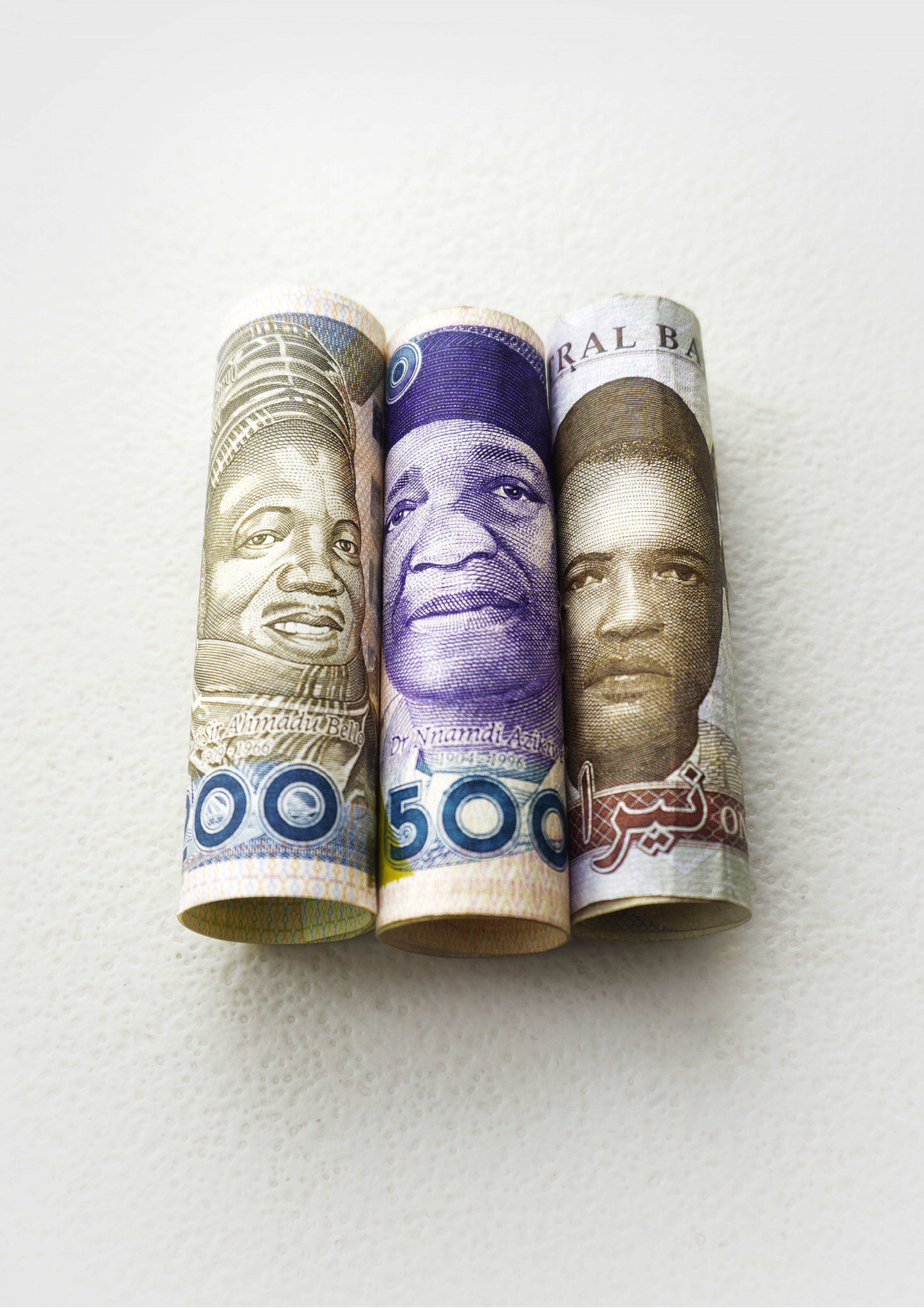
THE NIGERIAN ECONOMIC SUMMIT GROUP


Sir Ahmadu Bello
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1904 - 1996
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INTRODUCTION

The Nigerian economy faced complex challenges in 2022. One of the most significant of these challenges is the prolonged fuel scarcity, which appears to be slowing down economic activity, increasing inflationary pressure, eroding the purchasing power of the Naira, and pushing more Nigerians into poverty.

While ordinary Nigerians and many businesses were devising strategies to mitigate the effects of fuel scarcity and rising inflation, the Central Bank of Nigeria (CBN) announced plans to redesign the country's currency, specifically the higher denominations, on October 26th, 2022. The announcement came with a tight deadline of January 31st, 2023, to phase out the old N200, N500 and N1,000 notes - which account for 95.6 percent of the total value of the currency in circulation.[1]

The decision by the CBN to redesign some Naira denominations is not unprecedented in Nigeria, given the history of currency redesigns as obtained in 2007 and 2009 with the lower denomination banknotes. The Naira redesign policy is authorised by Sections 18 (a) and (b) of Nigeria's Central Bank of Nigeria Act of 2007. According to the Act, the CBN shall (a) arrange for the printing of currency notes and coin minting; and (b) issue, re-issue, and exchange currency notes and coins at the Bank's offices and such agencies as it may establish or appoint from time to time.

Both the reasons for the redesign of the Naira and the timing are important factors in examining the policy and the merits of the decision to redesign the currency notes. The CBN highlighted five (5) main reasons for its decision [2, 3]

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[1] CBN Currency Operation Department Annual Report (2020)

[2] Central Bank of Nigeria (2022). Naira redesign: What you need to know. Available at: https://www.cbn.gov.ng/Out/2022/CCD/Naira_Redesign.pdf

[3] Emefiele, G.I. (2022). PRESS REMARKS ON ISSUANCE OF NEW NAIRA BANKNOTES. Available at: https://www.cbn.gov.ng/Out/2022/CCD/Press%20Remarks%20on%20New%20Naira%20BanknotesOct2022%20Final.pdf

5 REASONS FOR CURRENCY REDESIGN

Hoarding of banknotes by the public

As of December 2022, N2.56 trillion (85 percent) out of the N3.01 trillion currency in circulation was outside the banking system. According to the CBN, hoarding of banknotes has led to a scarcity of decent and fit notes.[4]

Guard against currency counterfeiting

Producing fake Naira notes has become easier due to technological advances. The CBN noted an increase in the rate of currency counterfeiting. Therefore, a redesign was necessary to address the worsening problem of counterfeiting revealed by security reports.

Alignment with global best practice

The CBN stated that countries are to redesign their currencies every 5-8 years in line with international standards. This global best practice meant Nigeria lagged in redesigning its currency.

Curb insecurity

It is expected that introducing new banknotes would stem the tide of terrorist activities and kidnappings as monies outside the banking system are used to make ransom payments.

Promote price stability, financial inclusion and a cashless economy

Furthermore, the CBN stated that the policy might lower inflationary pressure, promote a cashless policy supported by the eNaira, and deepen financial inclusion as a reduction of currency outside the banks will induce the need to be financially included in order to engage in economic transactions.

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[4] CBN Press Statement by Godwin Emefiele, Governor, Central Bank of Nigeria, January 29th, 2023, on Progress of Implementation of New Redesigned Currency by the Central Bank of Nigeria (2023). Available at: https://www.cbn.gov.ng/Out/2023/CCD/Press%20Statement%20by%20Godwin%20Emefiele%20on%20the%20Progress%20of%20Implementation%20of%20New%20Redesigned%20Currency%20by%20Central%20Bank%20of%20Nigeria.pdf

Apart from promoting economic activity, the Naira currency represents Nigeria's pride and heritage, far more valuable than its face value and purchasing power - what it can buy. Cash is still central to economic activity in Nigeria, where about 90 percent of transactions occur using money. Therefore, chronic shortages, such as the Naira scarcity experienced since the fourth week of January 2023, due to limited Naira notes printed by the CBN, hoarding by financial institutions and digital financial platform breakdown/malfunction, have economic and socio-cultural consequences for the Nigerian economy and the general populace.

At a broader level, the Nigerian economy is facing continued exchange rate volatility, increased inflationary pressure, and other macroeconomic challenges. These issues have deteriorated socio-economic conditions, increasing insecurity, food shortages, and crime. While this is due to various structural problems, the effects of the pitiable execution of the redesign policy are exacerbating the economy's situation, mainly because of the prominent role of "cash-in-hand" to economic activities and the unpreparedness of economic actors for the rapid changes which have taken place. This report details an analysis of the CBN's Naira redesign policy to provide a critical way forward toward addressing the unintended realities emanating from policy implementation.

[5] BusinessDay (2023). Can Nigeria go cashless? Available at https://businessday.ng/technology/article/can-nigerias-economy-go-cashless/.

ISSUES EMANATING FROM THE NAIRA REDESIGN POLICY

Notwithstanding the potential benefits associated with the Naira redesign, which the CBN has captured well, the implementation of the policy has had some unintended effects which must be addressed. These include:

Currency/Cash Crunch

The Naira redesign policy is beginning to take a toll on Nigeria as the economy suffers from a significant decline in the volume and value of cash in circulation. According to CBN data, the currency's value in circulation closed at N3 trillion in 2022, below its values of N3.3 trillion and N3.2 trillion in October and November 2022, respectively.

To beat the Jan 31 2023, deadline for the old notes, people rushed to banks to deposit these notes. As of Mid-December 2022, only 500 million pieces of redesigned notes estimated at N390.3 billion had been made available by the CBN. Meanwhile, the redesigned notes should amount to N2.9 trillion in circulation to match the currency absorbed from circulation. This resulted in a shortfall of N2.5 trillion, translating into an 86 percent decline in total currency in circulation in three months.[6]

The cash crunch has had adverse effects on households, informal businesses and formal businesses, particularly the Nano, Micro, Small and Medium Enterprises (NMSMEs), which are the backbone of the private sector-driven economy. Some of these challenges are enumerated below:

* Long and unending queues are now common at banks as people often try unsuccessfully to withdraw cash. Time spent attempting to obtain new notes disrupts economic activities; makes it significantly difficult for people to engage in daily activities, as commuting becomes difficult or even impossible when cash is not in hand and when economic agents are not receptive to e-payment/bank transfers.

[6] NESG Estimate based on the CBN Currency Operations Annual Report 2022. See https://www.cbn.gov.ng/Out/2021/CCD/2020%20COD%20Annual%20Report%20(FINAL%20APPROVED).pdf

* The emergence of local money-changing agents and Point-of-Sale (PoS) vendors that exploit customers who must use cash rather than debit cards or mobile money transfers – by charging outrageous markups, as high as 20-30 percent

Increased pressure on the banking system

The limited timing for implementing the Naira redesign policy put the banking system under intense pressure. The failure of Deposit Money Banks (DMBs) to meet the growing demands for cash suggests that the banking system, given the existing technology, is unprepared for a sudden transition from the old Naira notes to the new ones or to csahless economy. Although the CBN extended the deadline for old notes as legal tender by ten days from January 31st, 2023, the pressure on banks has persisted.

Heightened social tensions

Social tensions have been rising recently due to inadequate cash in circulation and the uncertainty resulting from the policy. The excess demand for money has led to social unrest in many parts of the country, such as Ogun, Edo and Oyo states. Concerns over the implications of poor liquidity for the elections may also contribute to heightened tensions. As elections approach, which is often associated with an increased risk of violence, the unrest arising from the effects of the policy could fuel tensions.

WHY THE NAIRA REDESIGN POLICY HAS NOT TAKEN OFF SUCCESSFULLY?

Some of the reasons behind the practical difficulties associated with the Naira redesign can be deduced from the issues arising from the policy. These include:

Improper timing

The policy's expected implementation timeframe is relatively short (compared with the experience of the past and other countries), given that the economy is predominantly informal. India, a country with a large informal sector, abruptly demonetised approximately 86 percent of its currency in 2016 to combat counterfeiting and black-market dealings. Over several weeks, citizens rushed to banks to redeem their money for new notes. The economy faced a severe shortage of cash and long lines of people at banks. The demonetisation policy has been described as unsuccessful and is estimated to have cost the economy at least 1 percent of its Gross Domestic Product (GDP)[7] and 1.5 million jobs.[8]

Secondly, the Naira redesign policy was situated at periods (the end of the year – the festive season – and the peak of the election season) which come with high spending and the increased use of cash. The demand for cash is stronger than usual during these periods. Therefore, the timing subverts the policy's good intentions and inflicts hardship on the people.

[7] Forbes (2016). One Month in, What's The Impact of India's Demonetization Fiasco? Available at: https://www.forbes.com/sites/wadeshepard/2016/12/12/one-month-in-whats-the-impact-of-indias-demonetization-fiasco/?sh=7dd170a17ab1

[8] The Guardian (2018). Demonetisation drive that cost India 1.5m jobs fails to uncover 'black money'. Available at: https://www.theguardian.com/world/2018/aug/30/india-demonetisation-drive-fails-uncover-black-money.

High level of informality

The Nigerian economy has a substantial informal sector contributing about 65 percent to GDP. Unless the fair share of the informal sector is reduced drastically, the currency outside the banking system is likely to keep expanding, even when the new naira notes have been widely and sufficiently circulated.[9]

Low rate of financial inclusion

According to EFInA, the financial inclusion rate was estimated at 64.1 percent in 2020.[10] Much of the population is unbanked, making it difficult for this group to access the new banknotes beyond the difficulties those with bank accounts face. Unless a large chunk of unbanked adults is absorbed into the financial system, the CBN will find it arduous to rein in the currency outside the bank vaults.

Ineffective policy coordination

The initial face-off between the CBN and the Federal Ministry of Finance over the abrupt Naira redesign casts doubt on effective policy coordination between both jurisdictions. This would, however, undermine investors' confidence in the economy due to policy uncertainty, further elevating their apprehension ahead of the 2023 General Elections starting in February.

Lack of public sensitisation & stakeholders' engagement

While the CBN has the constitutional right to implement the Naira redesign policy, the inability to reach out to stakeholders in the industry to hone strategies for effective policy implementation and acquire stakeholder buy-in truncated the process. In addition, the general public was not adequately informed about the policy's motivation and benefits, resulting in ignorance and delays in adjusting to the new policy.

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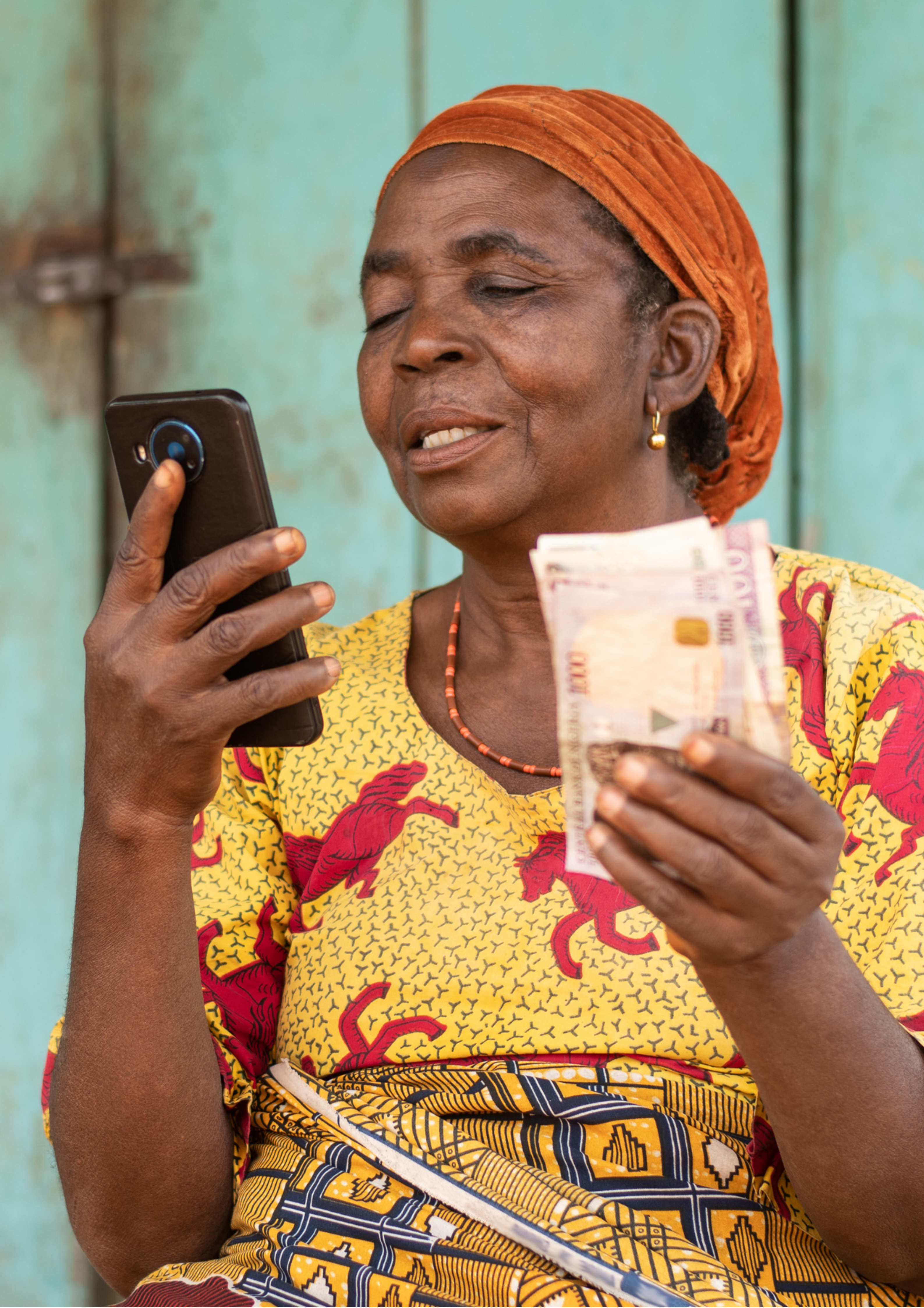
[9] Medina, L., Jonelis, A.W. and Cangul, M. (2017). The Informal Economy in Sub-Saharan Africa: Size and Determinants, retrieved from: https://www.imf.org/-/media/Files/Publications/WP/2017/wp17156.ashx.

[10] EFInA (2021). Access to Financial Services in Nigeria 2020 Survey, retrieved from: https://efina.org.ng/wp-content/uploads/2021/10/A2F-2020-Final-Report.pdf.



LIKELY OUTCOMES OF PROLONGED CASH CRUNCH

Macroeconomic Instability

The cash scarcity associated with the currency redesign policy will likely motivate a slowdown in economic growth as many productive activities have been halted due to the inability to access cash. Furthermore, the uncertainty associated with this policy and its economic effects may contribute to volatile movements in macroeconomic variables. Thus, the following socio-economic outcome would accompany the policy:

* The plummeting of productivity has implications for GDP and a domino effect on other economic indices. This can mean fewer job opportunities, increasing poverty incidence, thus adversely impacting the collective economic health of the population.

* As employment opportunities reduce, consumer spending will also decrease, resulting in an economic slowdown. This may consequently lead to decreased government revenue, primarily from non-oil sources.

* A lack of employment opportunities could impede access to education and healthcare, leading to a decreased standard of living. People would also have reduced spending power, which in turn would further hamper demand for goods and services. Ultimately, this could result in a population's overall decline in quality of life.

* The economic distress caused by low productivity, unemployment and inability to access cash could spur civil disobedience and amplify criminal activities, social unrest and security threats.

Restrain Local Trade and Regional Trade

The impact of the cash crunch will be most profound in the trade sector as business transactions become constricted and stiffened. Hence, there will be a slowdown in local trade. Moreover, given the integral role of Nigeria in West Africa's regional trade, the unavailability of cash will disrupt Nigeria's regional trade (inward or outward).

Constrain the Informal Sector

As previously highlighted, about 65 percent of Nigeria's GDP comes from the informal sector, which runs primarily on cash. The drought in cash means a shutdown of more than half the economy. The informal sector also employs over 80 percent of the labour force. A prolonged cash shortage with the attendant effect on business activity may also translate into a significant loss of jobs within this sector. Hence, economic activity in the informal sector will decline, invariably leading to a slowdown and potential recession in the overall economy.

Distrust in the Financial System

With nearly 40 percent of the adult population being excluded from the financial system, the challenges emanating from the cash crunch following the redesign will amplify the trust deficit in the financial system. Hence, many more people will resort to stacking up cash. This will be against the cashless policy agenda of the CBN and will defeat the essence of the Naira redesign policy.

Erosion of Investment Confidence

The Naira redesign policy, alongside other policies that have had unintended consequences, will continue to dampen investors' confidence in Nigeria. Policies such as this further compound the level of uncertainty in the economy, which disincentivises investors from committing their funds to the Nigerian economy.

4 IMMEDIATE ACTION POINTS

As laudable as the aims of the CBN were in its decision to redesign the currency, the evidence highlighted above indicates that there has been a myriad of unintended challenges which have been significantly disruptive to economic activity and negatively affected the welfare of citizens. Urgent redress is therefore required to stave off further adverse socio-economic effects and to restore confidence in the financial system. The NESG recommends the following:

Adopt gradual phaseout of old notes

Due to the hardship households and businesses face, especially in the informal sector, the CBN needs to reconsider prolonging the legal tender usage of the old notes side-by-side with the new notes. This is important to give the CBN the opportunity and time to devise effective ways of getting the new note to the unbanked populace and rural dwellers that constitute a large portion of the informal economy. As such, a gradual phasing out of the old note is advised.

Expedite the printing of new notes

The CBN should expedite the printing of new notes. Additionally, the apex bank should streamline distribution channels to ensure efficient delivery of the new notes to commercial banks and other financial institutions. This will help ensure an adequate supply of cash to meet the public's demand and reduce long queues and other inconveniences.

Intensify public sensitisation

The CBN should launch a public sensitisation campaign to educate the public on the need for new notes and the reasons behind the delayed printing process or scarcity of cash. This will help prevent negative vested interest narratives and misinformation resulting from an inadequate supply of cash. The campaign should emphasise the objectives and benefits of currency redesign. Also, there should be incentives to promote the use of digital channels, such as a reduction of charges on transactions associated with digital channels.

Strengthen the digital infrastructure

There is an urgent need to expand the capacity of the digital financial system to accommodate the mass migration to digital channels. This is important to ensure a seamless transition to digital channels as alternatives to cash. The difficulty experienced by people attempting to use digital channels for transactions suggests that payment platforms are not adequately mature to adjust quickly to a cashless economy.

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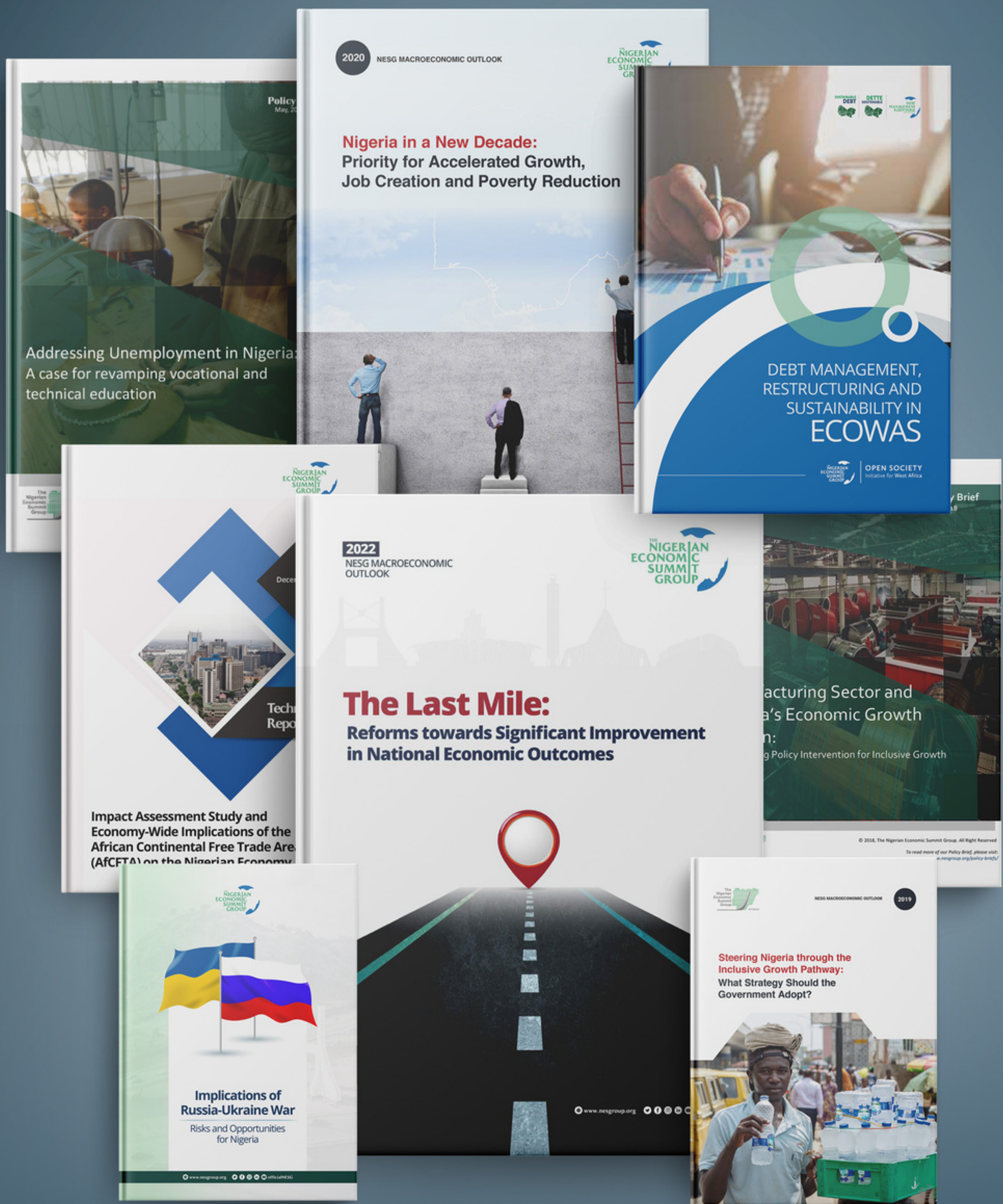

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Our views and positions on issues are disseminated through electronic and print media, seminars, public lectures, policy dialogues, workshops, specific high-level interactive public-private sessions and special presentations to the executive and legislative arms of government.

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