Chinese Currency Devaluation and the Economic Implications for Nigeria

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Abstract: The decision of Chinese government to devalue the Yuan has attracted serious condemnation by majorly developed economies, despite the government position that the devaluation was aimed at aligning the Yuan with the market rate. The general argument is anchored on the notion that the devaluation was a strategy to increase China's share of global trade by making its goods cheaper in the international market. This thinking is influenced by the long standing Mundell–Fleming model, which aligned with the theory that competitive devaluation is detrimental to the world economy, because of beggar-thy-neighbour welfare effect. The situation is compelling other countries to respond by improving their balance of trade in response to China tactics. The inability of developing economies to respond to this global trade war could be attributed to factors such as colonialism, presence of agency of restraints, complementarity among developing countries, and other institutional rigidities such as technological deficiency, infrastructure deficit, and commodity based exports, among others. Chinese currency devaluation has impacted meaningfully on the Nigeria economy given the fact that Nigeria maintains strong economic ties with China. The paper argues that for developing economies to effectively respond to competitive devaluation, they must close their borders to certain goods, improve infrastructure, prioritize technological transfer, embrace value-added production, and eliminate institution rigidities that hinder the ease of doing business.

Keywords: Trade politics, Currency war, External shocks, Economy.

1. INTRODUCTION

There are vast empirical and theoretical literatures on the relationship between exchange rate depreciation (appreciation) and trade balance. Competitive devaluation is expected to make a country's exports cheaper and increase exports (Mckinnon, 2011). This theory essentially influenced the devaluation of developing countries currency, during the Structural Adjustment Programme, in order to improve their competiveness in international trade. Though, for import dependent developing economies, with gross technological deficit and over-dependence on intermediate products for production, competitive devaluation could result to inflation pass-through, and stymie growth. For the less developed economies, currency devaluation would not attract global attention, because they are semi-opened economies, with commodity-based exports and lack the technological skills to effectively compete in the global trade (Alemu, *et al*. 2014). Some scholars disagree with the benefits of currency devaluation. Porter (1990) is of the view that devaluations could be detrimental; owing to the fact that a hyped exchange rate may be good for production increase by pushing for greater increase in productivity in the traded-goods area.

One major plight faced by developing countries during devaluation is that the cost of importation soars up. Many developing economies are import-dependent; hence devaluation poses a threat to them. With high importation cost, inflation rises. On the other hand, exports from developing nations which are specifically commodity goods become cheaper. Exports automatically become less incentive to manufacturers. Mustafa (2000) observes that devaluation has affected developing countries both politically and economically. One of the key components of structural adjustment programmes initiated for developing countries by IMF is real devaluation. The supervision exercise of the IMF according to Khan and Knight (1981) was to drive economic development. The need for currency devaluation among developing countries include: obtaining the correct prices and effecting price distortions, improving the balance of payments by reducing foreign trade deficit. When these issues are rightly addressed, developing countries will then achieve economic growth. These devaluation programmes never attracted global notice or condemnation because they are not major competitors and essentially export commodity products.

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On the other hand, currency devaluation among developed economies is treated with suspicion. This is largely influenced by traditional Mundell–Fleming model, which aligned with the theory that competitive devaluation is detrimental to the world economy, because of the beggar-thy-neighbour welfare effect (Juha and Philip, 2010). This model generally assumes that countries devalue their currencies in order to have greater access or share of the international market. Consequently, other competitors or developed countries could respond by improving their terms of trade at the expense of the country that devalued its currency.

For instance, the decision of the People's Bank of China to devalue its currency by nearly 2 per cent in August 2015 and subsequent depreciation of the Yaun against the US dollar by 1.6 and 1.1 per cent respectively has generated serious response among developed economies (Alan, 2015). Aside from the United States government accusing China of manipulating her currency, it has also been observed that the decision of the United States not to increase its short-term nominal interest rate in the last meeting (September 16-17, 2015), despite visible signs of US economy recovery could be a direct response to the devaluation of yuan. Specifically, allowing nominal interest rate to remain within the zero bands is akin to competitive devaluation, which has the ultimate objective of depreciating the dollar and boosting U.S. economic and export profile to the disadvantage of the global economy (Irwin, 2015; Inman, 2015). While developed economies could respond effectively to competitive devaluation by improving their terms of trade, the same could not be said of third world economies.

1.1. Research Questions

This above narratives triggered some key research questions below:

- What are the institutional factors or rigidities that have hindered developing economies, such as Nigeria from effectively responding to such market aggression?
- What possible strategies could be effectively implemented to counteract such market aggression?

1.2. Research Objective

The objectives of this paper therefore are:

- To specifically examine the institutional rigidities that have hindered Nigeria as a developing economy with strong trade ties with China from responding aggressively to such trade wars.
- To explore possible strategies to effectively counteract such market aggression.

1.3. Structure of the Paper

The remaining part of paper is structured as follows: Section 2 is on Currency use and Evolution of Competitive Devaluation. Section 3 examines Chinese Economy and International Trade. In section 4, we present the implications of the devaluation on the Nigerian economy, while section 5 concludes the paper.

1.4. Research Approach

This study is a theoretical cum conceptual paper, which was based on theory building through extensive literature reviews, and authors' observations. Secondary data from the Central Bank of Nigeria Statistical Bulletin and publications of the National Bureau of Statistics were utilized for the analysis.

2. THEORETICAL FOUNDATION

The theoretical foundations of this paper will be discussed in the ensuing sections

2.1. Currency use and Evolution of Competitive Devaluation

Trade is significant in instituting a legal tender as a global currency, particularly by satisfying the transactional and medium of exchange in addition to the unit of account concepts of needs for money. The currency that denominates a disproportionate share of international trade stands for an international currency. The use of the US dollar surpasses US international trade and therefore has become the dominant international currency (Krugman, 1984). A dominant currency is significant because it is widely used in commodity markets. The country that maintains reserve currency generates immense trade which provides economic advantage. Many countries use such currency as their reserve currency.

The relevance of a global currency is also noted by the reluctance of the users to drop it should the need to use other currency arise. Krugman (1984) is of the view that using a widely available and liquid currency lowers the transaction cost. Goldberg (2012) equally confirms the difficulty to displace well established currencies. This observation is in line with Chandrasekhar (2010) argument that US dollar became the global and reserve currency based on overall US strength. From all indications, once the country exporting goods and services is very big comparative to target markets, the legal tender of the exporting country is most likely to be adopted for transactions (Golberg and Tille, 2008).

The history of currency as legal tender could be traced to the International gold standard of 1925.Trade is closely linked to currency which stands as a measure of real competitiveness (Marc and Michele, 2011). Improvements in information communication technology and globalization have reduced trade barriers and improved international trade (Cunado and Perez de Gracia, 2005).Essentially, the unopposed position of the United States dollar as global legal tender was strengthened by the expansion of its financial markets (Kenen, 1983).

Currency devaluation has a strong capacity of transmitting external shocks to various economies. The effect of external shocks has been stronger due to globalization, bringing a whole lot of economy to a global village. External shocks can hinder economic growth. Extant literature on external shocks and economy reveals that external shocks can negatively impact on a developing country by affecting their debt sustainability, macroeconomic stability and further entrench poverty (World Bank, 2004; UNCTAD, 2002 and IMF 2003).

The financial liberalization programme adopted by the IMF in the 1980s was specifically for developing countries to devalue their currency. Emerging countries were encouraged to devalue their currencies in order to make their goods competitive in the international market. In the more recent time, expansionary monetary policies were introduced by the European Central Bank and U.S. Federal Reserve. The aim was to stimulate the economy during the recent global recession (Juha and Philipp, 2010). Currency devaluation by Chinese government in the most recent time occurred when there is decline in global trade. Major economic blocs may react in such a manner to trigger off beggar-thy-neighbour trade war to grab the major portion of global customer demand (Samina and Reema, 2007). This raises an important question on why competitive devaluation by countries with larger share of global trade market evinced serious interest among policy makers. For instance, it was due to the eagerness and anxiousness of producers to maintain sales that led to the introduction of many tariffs and multiple forms of trade barriers (Zeeshan, Asghar and Shahid, 2016). This triggered off the 1920s and 1930s economic depression. Economic Historians were strongly of the view that the 1930s crisis was as a result of political constraints. The European nations made effort to prevent hot money outflow through protection of their gold stocks .These measures worsen the crisis and by 1932 Britain abandoned its fixed gold parity (Eicherngreen and Temin, 1997). The values of Pound drop by 25%while Dollar became less competitive as export declined. Most gold bloc suffered decline in 1936 and the only option left for them was to get into “beggar-thy-neighbour” devaluation (Ronald, 2011).

In most recent time, China devalued its currency when there is already global trade decline. China has witnessed a drop in their export which is not peculiar to them alone. Other Asian nations competing with China once they hit back creates trade tensions and currency war. Retaliation by the world’s giant trading blocs took the shape of beggar –thy –neighbour battle so as to take over the greater share of global customer needs (Mac, 2012).

3. CHINESE ECONOMY AND INTERNATIONAL TRADE

The Chinese government advanced an economic reform as at 1979 bringing in so much transformation that moved China from a poor nation to a known economic power. Initially, the low production and investment was as a result of the country’s limited resources that made most firms relied much on imported equipment and design. The economic progress of a nation lies not just in their internal but also in external policies especially when it is directed towards attracting foreign investment by establishing special economic zones. This is remarkable in stabilizing income inequality (World Bank, 2002). Lardy (2001) attributed Chinese economic advancement to a highly consolidated foreign trade regime. Chinese economic reform integrated them with many other countries that as at 2003 for instance China ranked 2nd in terms of absolute purchasing power, 6th in terms of real GDP and in terms of inward flows of FDI, they ranked first (United Nations, 2005).

Chinese fast growing economy maintained a share of world exports of 13% in 2013 and by 2014 it came to 12.4% (Li, 2015). The United States of America has maintained the world's largest trading nation for a six period decades however, by 2013 China exceeded the US. While China maintained a 16.5% of the global market, US maintained 16.3%. As at December 2014 the Canadian and Australian dollars steeped down for Chinese Yuan, making the Chinese Yuan as the world's fifth most used currency in settling international transactions (Chandrasekhar, 2010).

In recent time however, China witnessed a decline in its economic activities among various countries. In Japan, Chinese exports decreased by 13% as at July 2014, and fell by 1.3% and 12.3% in United States and Europe respectively (Nick, 2015). The Chinese government made effort to boast the economy, but, Charan (2015) reports that as at 2014, the country's annual growth dropped by 6.8%. This slow growth triggered currency devaluation by China.

Currency trade relationship has been argued and debated upon globally (Marc and Ruta, 2011). The chief exports of most African countries are primary commodities. The commodity price drops each time there is a drop in global demand for raw materials (Dobre, 2008). It is a clear indication of the vulnerability of their exports. This is one major problem and challenge that developing country faces. Currency disasters are associated with quick recession especially for developing countries. Previously, the global commodities boom brought about an increased economic enhancement and developmental growth across many African countries. Some governments caught in on this boom developed policy reforms that stimulated diversification whereas some other believed such opportunities shall remain persistent and did nothing. The table below is a representative of some African countries and their chief export products.

Many African countries enjoyed economic growth at a time of global commodities boom. Few African governments hastened their economic diversification through policy reforms, whereas a greater number maintained their commodity trade. Commodity prices face fluctuations from time to time (Akyüz, 2016). The government can only take advantage of high revenue if they have a well-structured policy. Most African nations are facing economic crisis as a result of sharp drop in commodity goods especially oil. African nations are badly hurt due to heavy dependence on commodity goods. The oil communities countries like Nigeria, Angola, Republic of the Congo are the worst-hit (Essandoh and Yalamova, 2014).The sharp drop in commodity prices in line with Chinese currency devaluation further weighs more on the economic performance of African countries in general and Nigeria in particular (Urama, 2015). Most sub Saharan Africa are deeply affected by Currency devaluation of China given the fact that external trading activities has been shifted to China from advanced countries (Global economic perspective, 2016).

Table 1: Some African countries and their chief export

Country	Export
Angola	Oil
Benin	Cotton, oil
Botswana	Diamond, Nickel
Burkina Faso	Cotton, Gold
Cameroon	Oil
Congo	Oil
Gabon	Oil
Gambia	groundnuts Oil, groundnuts
Ghana	Gold, Diamond, wood, Aluminium, cocoa
Kenya	Coffee, oil
Liberia	Diamonds
Niger	Uranium
Nigeria	Oil
Rwanda	Coffee, Gold
Senegal	Fish, groundnut oil, oil
Sierra Leone	Aluminium
Togo	Cotton, phosphate
Zaire	Copper, Diamonds, oil
Zambia	Copper

Source: Authors compilation, 2016.

4. ECONOMIC IMPLICATION OF CHINESE DEVALUATION ON THE NIGERIAN ECONOMY

China has maintained a favourable external trade and had entered into economic relations with Nigeria. Utomi (2007) observes a marked rapid growth in trade between Nigeria and China around 1993.The trade transaction between Nigeria and China was so remarkable making Nigeria the second biggest China trade partner in Africa (Utomi, 2007). Djeri-Wake (2009) reports that, the volume of trade between Nigeria and China stood at $6.373billion as at 2009.China being a manufacturing based economy had a $5.476 billion export to Nigeria and an import of $0.897 billion. Similarly, Nigeria being an import dependent mono-cultural economy maintains a trade imbalance with China (Djeri-Wake, 2009).

Chinese currency devaluation was to combat trade imbalances, which China has suffered recently in international trade. A country can be more competitive with currency devaluation as such will cheapen their exports. Similarly importation heightens and discourages domestic users (Neil, 2015). Such competitive devaluation has been observed as currency wars (Alan, 2015). Such trade politics has lots of implications on the Nigerian economy. Presently in Nigeria, Chinese manufactured goods predominate in the country. Specifically, Nigeria imports intermediate goods and machineries used by processing industries within the country. By implication, the volume of high importation with minimal exports between Nigeria and China has remained disadvantageous to the Nigerian economy. The high level quantity of cheap Chinese products has a strong capacity to stifle domestic industries more so with the trade interaction between China and U.S (Autor, *et al.* 2016). This has a ripple effect as low production and capacity utilization in Nigeria-based industries must have worsen the unemployment rate in the country.

While importation from China became cheaper, exportation from Nigeria became more expensive leading to reduction in the demand for Nigerian exports. Besides the Nigerian domestic goods being less competitive in terms of export to China, the goods are equally affected negatively as cheaper imported goods makes them less desired even within the domestic market. There is a decline in the volume of export due to this devaluation. Tables **2** and **3** below reflect Nigeria- China trade statistics in terms of imports and exports.

Deficit balance of payment affected the foreign reserve negatively. The country's foreign reserved dropped drastically to 29.13billion dollars as at December 29th 2015 against 34.49 billion dollars as at Janaury 5th 2015 (Nwachukwu *et al.*, 2016).

Most developing countries cannot retaliate due to many factors. A key major incidence that has hindered effective response to competitive devaluation is colonialism. Most African countries were colonized, and as a direct result of this, some African countries still have strong ties with their colonial masters. This strong tie, in most cases makes it impossible for African countries to swiftly respond to competitive devaluation. This is even more, when the devaluation is coming from the colonial masters (Rawlins and Praveen, 2000). A good example is the Francophone West African countries. Their countries have strong ties with France. Their currency is linked to the Euro. By implication, this arrangement inhibits the ability of francophone countries to swiftly respond to competitive devaluation (Heather and Masson, 2003). This will not in the main, absolve other countries from such influence. International politics and events clearly showed that some African countries are unwilling to fracture their ties with colonial masters, through competitive devaluation, probably owing to grants-in-aids from the colonial masters. To further buttress this, the language used in most African governments is a relic from the colonial masters. Britain for instance followed a process of gradual transfer of power. Similarly, the French policy was also assimilated (Khapoya, 1994).

Table 2: Nigeria – China Trade Statistics (2013 - 2015) - Imports

Year	Nigeria's Total Imports (N' million)	Imports to China (N' million)	% Imports to China in the Total Imports
2013	7,015,814.70	1,475,928.30	21.04%
2014	7,374,370.50	1,616,790.90	21.92%
2015	6,697,965.90	1,567,686.10	23.41

Source: Nigerian Bureau of statistics (2015).

Table 3: Nigeria – China Trade Statistics (2013 – 2015) - Exports

Year	Nigeria's Total Exports (N' million)	Exports to China (N' million)	% Exports to China in the Total Exports
2013	14,245,271.60	170,736.40	1.20%
2014	16,304,041.20	264,610.40	1.62%
2015	9,728,797.70	157,485.10	1.62%

Source: Nigerian Bureau of statistics (2015).

Besides the incidence of colonialism, Agency of Restraint is yet another major institutional rigidity that can hamper competitive devaluation in developing economy (Sahil, 2015). Agency of restraint could hinder the ability of countries to respond swiftly to competitive devaluation. Agency of restraint could crystallize when smaller countries rely on bigger or exemplary countries to push certain policies. One typical example is the relationship that exists between United States of America and Kuwait (Sahil, 2015). Another classic example is the decision of Ghana monetary authorities to allow the Chinese Yuan as second national currency in order to stem the volatility of their exchange rate. Such policy would strongly inhibit the ability of Ghana to respond to competitive devaluation. Another major rigidity that African countries are facing is technological deficit. This entails that African countries do not have the technological know-how to address the putative global trade politics. Other factors are lack of basic infrastructure, poor production base, and absence of market power. Equally important is Lack of complementarities among member countries (all producing commodity based products).

5. CONCLUSION

The economic boom of the 1970s in Nigeria was mismanaged as Nigeria failed to diversify its economy. The major source of revenue had remained exportation of commodities chiefly the crude oil. Raw commodity products are less competitive in the global market. The inability of not just Nigeria but most developing Africa countries in general to respond to this global trade war could be attributed to the daunting challenges like poor production base, technological deficit, lack of basic infrastructure and absence of market power to influence the direction of global trade. To be relevant in the global market, most nations aspire to be technologically competitive by closing the technology gap so as not to be predisposed to external shocks.

Most of the developing countries of Africa have been adversely affected by Chinese recent currency devaluation. This is because China has a strong trade ties between most developing countries within the African region. For these countries, importation from China has become cheaper and has maintained an upward rise in importation of cheaper goods. Exportation from these countries to China becomes more expensive with a lower demand. This state of affairs has a negative effect on the balance of payments for most developing countries that have close ties with China. Ordinarily, a competitive devaluation like the Chinese's recent one will compel developed economies to retaliate. Developing countries on the other hand cannot engage in any currency war due to all the institutional rigidities

It makes an economic sense for countries to add value in their production, as this will be an important element of competition. When products are fashioned to have global value added, it creates opportunities for employment and economic development. African transition from primary production to value creation continent is pertinent. Manufacturing for instance declined from 27% between 2000/2004 to 16 % between 2010/2014. Again, though Africa is blessed with fertile and arable land, agricultural export is below 12% (Ritesh, 2015). The unstable nature of commodity prices, which is highly volatile and do not maintain an upward trend, points to the need for fiscal discipline, diversification and policy reforms.

6. POLICY IMPLICATIONS

Attention should be given to value-added activities, as developing countries need to strategize in such a manner that trade and investment can create opportunities for development and spur economic growth.

Some African countries at some point maintained a rising trend in commodity prices and utilized it while some others believed it was a rental economy. There is every need to sure up savings during positive shocks in the Africa economy in general and Nigeria economy in particularly with their large population.

Reforms to bridge infrastructure gap must not be neglected and must be given utmost attention. This will drastically reduce the cost of doing business, promote production and drive the economy. More than that, Priority should be given to skill acquisition in the form of technology transfer for global competitiveness.

Most African oil rich countries should work towards a fiscal consolidation which is directed towards the non-oil sector. This is no longer a time to pay lip service to the urgent need of the country to diversify. Every move towards strategizing must be encouraged.

Chinese's economic transformation target prompted technology independence. Such technology advancement is worth emulating by the Nigerian government. Although Nigeria currently decided to keep a third of its reserve in Yuan to minimize the monetary constraints and demand for dollar, more needs to be done. The country cannot stop by just adding the Yuan to the basket of currencies but need to diversify away from oil sectors to non-oil sectors. This putative diversification will boost export, which will impact positively on the country's GDP.

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