Impacts of trade liberalization on nigeria

Introduction

Despite the submission of some literature confirming the positive association between trade liberalization and poverty alleviation, it remains a complex ordeal to clearly state if trade liberalization is positive or negative for developing countries.

Winters et al (2004), Reimer (2002), Stiglitz &Charlton (2005), George (2010) identified various connections between trade liberalization and poverty alleviation , such as the price and availability of goods, factor prices, revenues from export, incentives for innovation and investment, short term risk, and development of terms of trade .

The long-established argument in support of a positive relationship between trade liberalization and poverty alleviation which exhibits the socio-economic and welfare impact of trade liberalization. First is the argument that many poor people work in the agricultural sector where trade distortions are most high, thus the consensus is that trade liberalization could pave way for higher global prices of agricultural and could lead to higher production and profits in third world countries (Panagariya 2005; Chang 2005; Deaton 1999).

The foregoing however could yield negative outcomes ; which can come in diverse ways such as , decrease in import duties which might reduce custom revenues allowing a cut in government public receipts resulting in a shrink of government transfers(Dornbusch 1992; Busse &Großmann 2004). Also, the terms of trade can be negatively influenced from the perspective of import price increases or export prices drop emanating from stern competition in export markets. Lifting trade barriers in a particular country also paves way for increase in import competition which leads to the reallocation of productive factors which induces short term risks and adjustment costs (Edwards 1993; Stiglitz et al 2006; Lall et al 2006).

The Economic Partnership Agreements(EPA) however reflects the arguments for and against trade liberalization. Since 1975 the African , Caribbean and Pacific group(ACP) of countries have gained non-reciprocal preferential access to the European Union Market(Price Water Cooper house 2007). The EPA is basically aimed at creating a Free Trade Area between ACP countries and the European Union(Mete 2006). The merits and demerits of such an agreement has been widely debated by different scholars with submissions such as ; possibilities of enhancing economic growth, technological development increased trades and the negative aspects as loss of tariff revenues which are major part of government revenue , elimination of custom duties on imports from trade with the European Union and decline in domestic government revenue, reduction of welfare benefits , tax reforms and stern economic policies, undermine regional integration, poverty aggravation, de-industrialization of developing countries, granting European corporations right over third world economies (actionaid. org; Seekat 2010; Bouët 2008). The examination of the history of Nigeria is crucial before going into full analysis of the impact of trade liberalization.

1. 1 Historical Background

Nigeria is a country with over 140million people, ranking as the highest populated African country. It attained independence in 1960 from the British government. Despite periods of instability(Military rule / dictatorial rule), in 1999 Nigeria returned to democratic rule (Bureau of African Affairs , 2010).

The country at independence was dependent on agriculture, but abruptly shifted to the exploitation of crude oil which led to the partial abandonment of agriculture at the expense of crude oil exploration and exploitation making it the sixth largest producer of crude oil in the globe and fifth supplier of crude oil to the United States in 2010(US EIA 2010) .

Nigeria possesses a history of short term trade policies; this are mostly aimed at securing balance of payments viability and enhancement of exports . Other anticipated uses include , industrialization policy , employment creation, self sufficiency policies to mention but a few (Mete 2006). Trade policies in Nigeria can be categorized under pre Structural Adjustment Programme (SAP) era , post Structural Adjustment Programme era policies(Mete 2006).

One of the recent features of Nigeria's trade policy centres on certain product bans or import bans , while tariff in 2002 have declined , the number of products that are subject to bans have increased significantly. Below in Fig 1 , are the list of products in diverse sectors that have been banned . The extent to which these bans were enforced remains questionable, as there were exemptions granted. It is estimated that 8 percent (US $1. 8 billion) of the official imports in 2006 were in tariff categories that had a complete ban and another 1 percent in tariff category that had partial bans (Adriamananjara et al 2009).

Apart from the ban or prohibition list, Nigeria sustains high tariffs in a number of sectors. The Nigerian tariff schedule though simplified in 2005 and aligned with the ECOWAS Common External Tariff with the maximum rate reduced by 50 percent which is above the ECOWAS proposed rate of 20 percent. Some products however still abide by the 50 percent tariffs such as sugar, rice , cigarettes , plastics, tires , vehicles to mention but a few. The implication of this in the short term implies that if trade liberalization is adopted in line with the EPA, it would probably lead to welfare reducing and trade diversion(Busse &Großmann 2004).

Key Economic Indicators and Trade flows

Starting with the empirical analysis which gives a rough view of social and economic indicators of Nigeria and some West Africa countries as would be represented by some data’s. As would be seen in Fig 2 as reflected in the appendix , most of the ECOWAS countries to which Nigeria belongs , have a relatively low income levels which is measured by the Gross National Income per capita(GNI). Nigeria for instance has a Gross National Income(GNI) of US $ 1, 190 with Purchasing Power Parity (PPP)of US $ 2, 070. Ghana for instance has the same GNI as Nigeria, but the PPP of Ghana is lower than that of Nigeria, with Ghana having a PPP of 1, 530 a little below that is the PPP of Benin Republic which is 1, 510 . An examination of Fig 2 (see appendix) reveals that there are disparities in the GNI and PPP of ECOWAS member countries(World Bank 2010).

Also, the Human Development Index (HDI) for Nigeria is among the lowest in the globe, with other members of ECOWAS having low HDI. Nigeria ranks 142 in the globe in terms of HDI ranking and a composite indices of its HDI value of 0. 423(UNDP report 2010).

The overall real GDP increased by 7. 23 percent in the first quarter of 2010 against the 4. 50percent in the corresponding quarter of 2009 as shown in Fig 5 below. The 2. 73 percentage increase in Real GDP growth in the first quarter of 2010 is accumulated from the increase in the production in the crude oil sector of the economy(nigerianstat. gov).

Methodology and Data

Since the main aim of the study is to examine the impact of trade liberalization on the economy of Nigeria as well as its welfare, the interdependences can be known through the application of a Computable General Equilibrium (CGE) model.

CGE model combines the application of economic theory and empirical data to create a practical tool for the exploration of economic policies , like changes in tariffs and their impacts on the economy. They utilize mathematical formulas that represent the behaviour of several economic agents ranging from consumers, governments, sectors, and factors of production(Krugman &Obstfeld 2000; Bouët 2008). The economic structures combined together creates an accounting system which allows that all resources constraint are accounted for , and theoretically , the flow through and feedback impacts of policy changes. In this study, the Global Trade Analysis Project model (GTAP)database would be utilized in exploring the implications of multilateral trade agreements from the perspective of the EPA on Nigeria.

3. 1 Salient features of the GTAP model

The GTAP model is depicted as a multi-country , multi-commodity model that is utilized for comparative static analysis of trade policy issues (Hertel &Tsigas1997). The model considers the following features; the regional household from which the income of factors, tariff revenues and taxes signifies the consumer side. Regional household is categorized into the following; private household expenditures, government expenditures and savings, the variable of consumption of private household thus can be examined by applying the non-homothetic Constant Difference of Elasticity (CDE) function (Cline 2004).

This is applied by assigning a representative producer for each sector in a country or region ; the representative producer makes crucial decisions to exploit profits by utilizing factors of production and produces a single sector output. However, producers could also alternate primary factors for each other, the alternation possibility is represented by applying the Constant Elasticity of Substitution (CES) functional form. In this case, intermediate goods are assumed to be in fixed proportions. In the case of agricultural products, farmers make decision on land allocation, thereby intermediate inputs are produced locally or imported, while primary factors are immobile. Internationally traded goods or exports are differentiated by the country or region of origin(Dimaranan et al 2006, Bouët 2008).

Armington(1969) submission can be applied to the foregoing, this implies that wheat or any agricultural products imported from the other parts of Sub-Saharan countries is distinct from wheat imported from the European Union, this amounts to trade flows that have their own distinct price tag. The merit of Armington's submission is that it takes into consideration the bilateral trade flows alongside bilateral trade policies, which can be used in analyzing trade preferences that deals with developing countries (Hertel &Tsigas 1997).

The GTAP model adopts two global institutions; the transport sector and the global bank sector, the transport sector reduces cost based on Cobb-Douglas technology and production function (Barnett 2007). The global bank however receives savings from the entire regions and buys investment in goods in the entire region based on the expected rates of return. The savings are mainly used on investment that are savings driven , in the static GTAP model however current investment is perceived as not influencing economic activities through its impacts on patterns of production in the capital goods production sector in each region represented(Hertel &Tsigas1997). The global bank also assures that global trade taxes generate imported intermediate inputs , additional taxes can then be situated either on domestic or either applied at differential rates that separate against imports and savings(Hertel &Tsigas1997).

In this case, the welfare changes are measured by Equivalent Variation(EV) , taxes are included also in the GTAP model at several levels, with the categorization of taxes as represented by production taxes from intermediate or primary inputs or outputs (Hertel &Tsigas 1997). Trade policy instrument stand for import or export subsidies or either taxes, the common feature in most African countries is unemployment and a low human development index. This addresses the inconsistency regarding general equilibrium of full employment factors of production, therefore in this study modifying the GTAP model to accommodate the unemployment of skilled labour in Nigeria . The foregoing would be attained by assigning the minimum wage rate , and allowing the volume of employment of unskilled labour adapt to it. This however might introduce an adjustment in the real wage in the labour market.

3. 2 Data and study simulation

The study is based on GTAP 7. 0 data base with an aggregate of 113 regions in the globe, African database and 2004 country data for Nigeria. The new version of GTAP has updated national, economic, although the regional trade data's are disjointed. GTAP has also integrated trade preferences , specific tariffs alongside non -tariffs barriers, the enlargement of the European Union to 27 members and the removal of export subsidies on agriculture. The GTAP database also includes 39 regions, 30 are African regions and the 9 others are aggregated regions alongside 57 sectors.

The current study however aims at examining the socio-economic impact of the EPAs from the individual country level, the GTAP data for Nigeria would be applied. The commodities of Nigeria as represented in the GTAP 7, would be reduced from the 57 sectors to 13 broad sectors as shown below in Table 1and 2 (in the appendix).

3. 3 Policy Scenarios

The study examines the important issues regarding the effect of the EPAs on trade, GDP, terms of trade, employment and welfare in Nigeria from an individual country perspective. The simulation therefore involves full removal of import tariffs and tariffs equivalent to bilateral non tariffs , lifting of ban on certain products. The scenarios include :

European Union(EU)-Nigeria : if Nigeria eliminates its tariffs on 50 percent of its imports from the EU 27, while the EU is supposed to grant duty free access to all African Caribbean and Pacific (ACP) products to its markets while attending to the issue of sensitive products.

If EU -Nigeria 80 percent reciprocation: this is similar to the first scenario , but the difference is that Nigeria reciprocates tariff elimination on 80 percent of imports originating from the European Union.

EU-Nigeria (reciprocity in full of preferential tariffs): FTA or Free Trade Agreement between the EU-27 and ECOWAS from the perspective of the EPA negotiations. The resulting effect leads to full reciprocity of preferential tariffs from both sides; which would be estimated by simulating a complete , symmetrical removal of imports protection.

Nigeria lifts ban: if Nigeria lifts its ban on certain goods that have been banned recently or previously.

The simulation would focus on the four experiments and would be carried out by standard GTAP closure which includes variables such as output, prices, factors of production, adjustment to external shocks. The selected experiments are also extended to unemployment closure, where the minimum wage for unskilled labour in developing countries are fixed and the resultant effect is re-establishing changes made in terms of the quantity of unskilled labour.

The reference experiment of full reciprocity between both parties is repeated by the lift on ban that allow a substitution of tariff revenues to lead to loss of revenue , Value added Tax (VAT) on private consumptions or income tax. This would reveal the welfare effects of the EPA.

4 Simulation Results

Tariff revenue impact

The impact on fiscal revenue showed in the Tables 3 to 3. 3 below, exhibit that by simulating distinct scenarios without addressing fiscal compensation, amounts to a decrease in government revenue in Nigeria. Since the EPA expects a fiscal compensation, it leads to issues such as change increase in tax on private consumption within the VAT system , alongside lost tariff revenues in the process of liberalizing trade between EU and Nigeria. From the scenario , if the tariff revenue is not changed, it leads to huge transfer of receipts from EU to Nigeria, so the basis is finding the correct tariff revenue formula to meet the needs of EPA. If bans are lifted however it leads to more transfer of receipts from Nigeria to the EU.

Employment and Welfare impacts

The standard GTAP model assumption makes use of full utilization of resources; this might not be useful in the case of Nigeria , especially in terms of unskilled labour which is in excess. The GTAP simulation discloses that welfare might be affected by reallocation of existing resources , price of imports and exports as affected by terms of trade effect, welfare may be influenced relatively by the amount of resource endowments, welfare may also increase diversity of net flows from the country of origin and destination.

Conclusion/Policy implications

The GTAP simulation has disclosed trade liberalization as :

leading to either a change in structure of the economy or reforms : this is evidenced in the current level of tariffs and ban on importation of certain products in Nigeria. Adoption of FTA from the provision of the EPA would lead to a structural adjustment in a country without strong institutions and corruption.

Having a trade diversion and dumping effect on Nigeria: lifting bans on importation , leads to dumping and encouraging the closure of domestic firms that can no longer compete again with cheaper products imported

Evoking a shift in trade patterns which in the long run would weaken regional integration , with Intra trade in ECOWAS fading away gradually, Nigeria trading with the EU strongly retracts inter-trade within ECOWAS and as such might lead to diversity in growth and economic structure both internally and externally(the other members of ECOWAS are structurally affected).

an impact on welfare from the perspective of job creation for the unskilled labour in agricultural sector, however a transition to industry produces skilled labour through training of resources, which in the long run leads to employment expansion and technological advancement in production.

Might contribute to growth diversity in the region: adopting trade liberalization as represented by the EPA would lead to gainers and losers in certain sectors. As a result of trade diversion, the competitive advantage of different economies differ, as such the profit margin from different countries compared to their export or import percentage annually might lead to diversity.

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