



African continental free trade area (CFTA) and the Nigerian economy: Should Nigeria Join?

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Abstract

The Nigerian action of declining to sign the agreement for creating the biggest regional free trade area in the world may not be justified. The creation of the African Continental Free Trade Area was a welcome development in the continent but Nigeria, which is the largest economy and most populous country in the region, decided to withdraw from signing the agreement. This study uses data employs a descriptive analysis of data sourced from the annual reports of the Central Bank of Nigeria and finds that Nigeria can benefit more than any other country in the region. Hence, joining the Continental Free Trade Area will be a good decision if the objective of the government is to improve the productivity of the private sector as well as the welfare of the people. However, the major obstacles to doing business in Nigeria, must be address. These issues are the poor electricity supply, difficulty in accessing finance, corruption, tax rates and transport.

Keywords: Africa, continental, free trade area, trade openness, Nigerian economy, international trade

1. Introduction

Forming the world largest regional market in Africa is a big step towards developing the continent because of the potential opportunities that explored by both the governments and the private sectors of the countries involved. Extreme protection of local industries in Nigeria and many other African countries has been one of the major reasons for the underdevelopment of the industrial sector, especially the manufacturing industries. It is well documented in the trade literature that domestic firms lack adequate capital required to propel rapid growth of the industrial sector partly due to unfavourable financial institutional policies and lack of strict adherence to the existing ones. Local firms lack the capacity to employ modern technologies and have deficient management knowledge/ skills. Therefore, involving in international trade and attracting foreign direct investments could be a suitable approach towards rapid industrialisation. Regional integration is one of the platforms for such viable options to be achieved.

According the UNCTAD (2007) ^[7], regional economic integration/ cooperation occurs in various forms and degrees and it is generally aimed at increasing cross-border linkages and deepening interpenetration of economic activity for the collective benefit of the economies involved within the region. A distinction is often made between policy-induced integration, which is equally known as regionalism and entails formal economic arrangements, and market-driven integration. Market-driven integration, also called regionalisation, is spurred by regional growth dynamics, the emergence of international production networks and related flows of foreign direct investment (UNCTAD, 2007) ^[7]. Formal integration can pave the way for the creation of cross-border input-output linkages which is essential for productivity improvement and innovation enhancement across the region. Furthermore, as such external linkages intensify, the domestic firms tend to upgrade and therefore improve the quality and standard of their products which is good for both consumers and government.

It has been argued that as developing nations become more

defenceless and loss national policy autonomy in the process of globalisation, regional economic cooperation can also be a defensive response in the belief that a regional integration will soften the influence of global factors and support them to handle globalisation in an appropriate manner. In this view, regional integration can equally fill gaps in global economic governance structures (UNCTAD, 2007) ^[7].

On the 21st of March, 2018, in Kigali, Rwanda, 44 leaders signed an agreement to create the African Continental Free Trade Area (AfCFTA). Reports have shown that if approved by each country, AfCFTA will become one of the world's largest trading blocs. However, there was a conspicuous omission—Nigeria, Africa's largest economy and most populous country in the continent, as well as a host of other countries declined to sign the agreement.

The potential benefit of a free trade area across the African Continent is substantial because it will create a single market of up to 1.2 billion people and a collective GDP of more than \$2 trillion. According to the United Nations Conference on Trade and Development (UNCTAD, 2016) ^[7] reducing intra-African tariffs—which is one of the conditions of AfCFTA—is capable of generating about \$3.6 billion in welfare improvements to the continent via enhancement in production and cheaper goods. The United Nations Economic Commission for Africa also explained that intra-African trade can increase by 52% by 2022 when compared to 2010 trade levels. This will be a great achievement for the continent because it will represent major growth since the present reality is stark with intra-African trade making just 16% of total trade on the continent in 2014.

Trade among ECOWAS member countries is a big example that can be advanced in support of the ACFTA. It has been observed that despite the underdevelopment of the non-oil export, in ECOWAS, Nigeria still plays a significant role in intra-regional trade. The value of trade between Nigeria and other ECOWAS Countries in 2013 increased by the following proportions over 2012. Trade with Ghana improved by 24 percent, Cote d'Ivoire 23 percent, Benin Republic 25 percent, Burkina Faso 293 percent, Guinea 124

percent, Senegal percent, and Liberia 26 percent. Moreover, the ECOWAS Trade Liberalization Scheme (ETLS) undertaken by ECOWAS countries to promote intra-regional trade among its members towards the creation of a common market has been a big approach. The ECOWAS Revised Treaty, include the abolition of customs duties levied on imports and exports and other non-tariff barriers among Member States in order to establish a Free Trade Area in the Community. Like the other regional trade integrated area all over the world, ETLS is the foremost Trade Facilitation scheme put forward by ECOWAS in the Community. Since the admission Nigerian companies into the Scheme, Nigeria being the largest economy in the ECOWAS sub-region benefits more from ETLS till date. This is because the ETLS makes made-in-Nigeria products competitive in the ECOWAS market amidst goods from Asian and Europe. In a manufacturing survey in Nigeria by UNIDO-CSAE conducted in 2004, it has been observed in the firm level data that lack of demand is a problem that flows from the low level of exporting that dominates the Nigerian manufacturing sector. Argument has been advanced that as Nigeria is a large economy, the manufacturing sector can safely depend on local market without worrying about exporting. Based on the data in the survey, however, firms do not grow because they overwhelmingly depend on the domestic market (Malik, Teal & Baptist, 2006) [4]. The few export-oriented firms show some evidence that they have the ability to grow faster. Hence, being able to export is an indication of improved productivity and the firms can compete regionally and globally.

The most essential aspect of the Continental Free Trade Area is the large size of the market of about 1.2 people of which Nigeria constitutes only a maximum of 17 percent. The first benefit of joining this bloc to Nigeria is improving access to the markets of its partner countries. This should be one of the motivating factors to take part in the CFTA. Based on the trend of Nigeria's non-oil export to other ECOWAS countries, it is clear from figure 1 that Nigeria stands to benefit most from the union because its export has been growing upward except for the recent years due to insecurity in Nigeria. Secondly, Nigerians will stand to gain in terms of job creation because foreign direct investment inflows from other African countries is associated with employment generation in the receiving industries. the productivity of domestic firms will be improved due to competition among the member countries. This will also lead to quality upgrading and price reduction thereby improving the welfare of the people.

However, the right thing must be done in order to maximise the benefits of the CFTA. According to Oyelola (2016) [5], the right and most appropriate way out of the currently under ravaging the Nigerian economy is formulation and implementation of economic policies that will strengthen the manufacturing sector and attract foreign investors both as Foreign Direct Investors (FDI) and Foreign Portfolio Investors (FPI). This is because the manufacturing sector is critical to every economy across the globe and Nigerian case is not an exception. according the President of the Manufacturers Association of Nigeria, Oyelola (2016) [5] "a spectacular lesson of globalization is that local markets no matter how large are no longer a guaranteed platform to promote industrial productivity. That is why countries like China and India have incorporated export trade into their respective foreign policy as a way to strengthen their position

in international trade. Thus, the manufacturing sector which is strategic and instrumental to revamping the economy wants the government to revive the Export Expansion Grant (EEG) which actually is the only incentive that has served as a catalyst to boost on non-oil export in Nigeria. All over the world, even in developed countries where there are no infrastructural deficiencies like we have in Nigeria, government give incentives to their manufacturers". Hence, implementing government policies towards supporting the industrial sector is very essential.

This study is therefore an attempt to provide a policy decision guide to Nigeria as the country is yet to final its decision to join the African Continental Free Trade Area. The study employs descriptive approach to examine the data collected from various issues of annual reports of the Central Bank of Nigeria. Following this introduction, this study is organised into literature review, results and discussion as well as recommendations.

Literature Review

Trade among countries has long been the emphasis of neo-colonial and contemporary growth theories. Endogenous growth models assert the effect of export on productivity and innovation (Grossman & Helpman, 1991, Helpman, 2006) [3]. These theories support the linkage on the basis that exporting helps firms to improve their productivity through innovation as well as transfer of technology. It has been argued that international trade and foreign direct investment have been amongst the fastest growing economic activities across the globe (Helpman, 2006).

It has been described as an engine of growth and has tremendous benefits to all countries. Such benefits include increased production, acquisition of new ideas and technology, poverty reduction and employment generation, among others. Many developing countries, however, have not benefited much from global trade arising, largely, from the un-competitiveness of domestic goods and services occasioned by low quality and high prices relative to foreign-produced goods and a concentration on primary products, as well as non-diversification of the economic base. These factors contributed to the low level of global trade (CBN, 2013).

Trade facilitation, therefore, is required to improve trade with other countries by reducing the transaction costs of clearing goods and ensuring transparency and effective coordination of activities at the ports. It would promote compliance with, regulatory requirements and increase the country's ability to use the benefits of market access; ensure free flow of goods and services; increase foreign direct investment; ensure efficient collection of government revenues; and generally, enhance economic development (CBN, 2013).

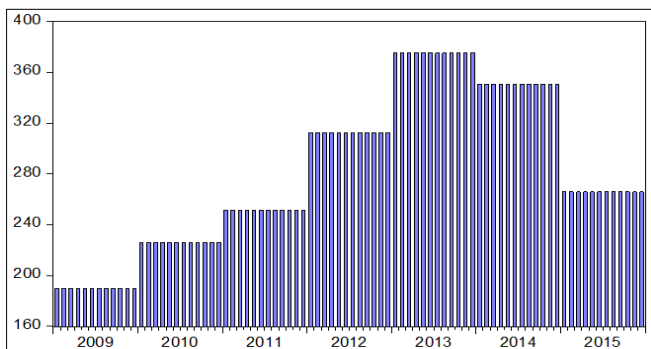
"The vulnerability of many African economies is their extreme dependence on export of natural resources and primary commodities. Without value addition, Africa is unable to derive maximum benefits from its abundant raw materials" (UNIDO, 2011). According to UNIDO report, industrial diversification and growth, faces a number of hurdles, which create a major policy challenge for Africa and other low-incomes countries.

It is well documented in the literature that unlike firms that operate within a closed or highly protected market setting, firms in an open and liberalised trade environment benefit substantially from the export and flow of modern technology and knowledge from other countries. Export oriented firms

tend to become more productive over time because of the learning effect linked with exporting and the spillover effect of improved technology created and employed by the developed countries (Sharma, 2017) [6]. By exporting to international markets, s exporting firms may face stiff competition which can force them to invest in technology and innovation so as to remain competitive. Export oriented firms are exposed to superior foreign knowledge and technology, and this helps them to learn and improve their productivity. Chete and Adewuyi report that while the share of Nigeria’s agricultural exports declined from 3 percent in 2001 to nearly nothing in 2009 and 2010, the share of manufacturing in Nigeria’s total exports to the ECOWAS region scaled from 1 percent in 2001 to 5.4 percent in 2010. Similarly, the share of other ECOWAS member countries in Nigeria’s imports fell from 4.4 percent in 2001 to below 0.5 percent in 2010. They emphasised that national and regional industrialization strategy should give concentration on transformation of agricultural products into finished/manufactured goods as well as the provision of high technology services at competitive prices to increase the potential for trade within the ECOWAS region. Production sharing, cross-border input supply and conditional incentives for exports are among the recommended factors to consider to foster the development of local and regional value chains and export competitiveness. There should be value additions in certain agricultural products such bananas, sweet potatoes and sugarcane which could be processed, well packaged and before exporting. It has also been argued that there is a considerable potential for Nigerian trade in timber, limestone and marble which should be explored through regional value chains including for products such as textiles and apparel. Afolabi, Danladi and Azeez (2017) [1], argued that the major reasons why Nigeria has not been able to attain economic growth and diversification through international trade include lack of good governance, poor policy design and implementation and unfavourable external environment, corruption, insecurity, poverty, infrastructure development, and poor human capital development.

Results and Discussion

Data collected from CBN’s annual reports on the volumes of Nigeria’s non-oil exports to other West African Countries have been presented using bar chart. The motive for the chart as shown in figure 1 is to examine the trend of non-oil exports from Nigeria to other regional market which helps in understanding the favourability of the trade to the Nigerian economy.

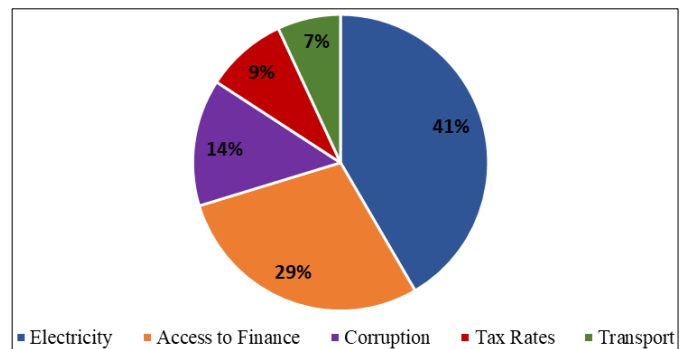


Source: plot by author using Date from CBN annual report (various issues)

Fig 1: Nigeria’ non-oil export to export to ECOWAS, 2009-2015 (\$ billion)

It is obvious from the chart that non-oil exports from Nigeria to other ECOWAS member countries have been growing rapidly as the value takes upward step each year. This rapid increase can be explained by the fact that Nigeria has advantages in agricultural commodities and in many light manufacturing such as plastics, shoes, beverages and tobacco. The Nigerian non-export increases by 19 percent from 2009 to 2010 and to 24 percent in 2012 explaining the speed at which Nigeria’s export can grow. However, a substantial decline of about 7 and 24 percent were recorded in 2014 and 2015 respectively, possibly due to the intensity of insurgency in 2014 and the general elections in 2015 which severely affected the production and export capacity of the country. this therefore goes to indicate that if all African countries come together, the benefits for Nigeria will be substantial. There will be many options for businesses to explore sources of buyers and supplies and this will encourage creativity and innovation among the Nigerian entrepreneurs.

It is important to note that as protecting domestic firms is not a good option for Nigeria, joining the Continental Free Trade Area cannot just boost the productivity and competitiveness of the firms under harsh business environment. Based on the World Bank’s enterprise survey 2014, five major obstacles to doing business in Nigeria have been presented in figure 2.



Source: Constructed by the Author based on Survey data from World Bank, 2014

Fig 2: Five Top Obstacles to Doing Business in Nigeria

It is clear from the chart that electricity is the top major obstacle to doing business in Nigeria as perceived by the firms in the manufacturing industry. It constitutes 41 percent of the major problems faced by the firms in the course of their business operation. Since energy supply is one of the major inputs in the production process, this can explain why many firms in Nigeria have closed down while the remaining ones are performing far below their capacity utilisation. It can also partly explain the lack of confidence in both the firms and the government to face any stiff competition from foreign firms within the African continent Hence, even if the government and other individuals believe that protecting domestic firms can be a good policy for industrialisation, certainly, no industrial development can occur under the condition of poor supply of electricity Nigeria per day.

Next to electricity is access to finance, representing 29 percent of the major obstacles to doing business in Nigeria. This is a clear indication of either poor credit policies by the government towards the private sector, especially manufacturing sector, or the inability of the financial institutions to facilitate industrial development in the country due partly to their alternative means of getting cheap profits

with little risks. It has been reported that majority of the small scale and some medium sized business find it very difficult to access loans from banks partly due to lack of collateral. This has prevented many potential entrepreneurs from venturing into productive and employment generating businesses while those in the business find it hard to survive. Hence, their productivity and competitiveness are severely affected because of the problem of accessibility to credit. Excessive government borrowing from domestic financial markets and the preference of politicians over entrepreneurs when it comes to the issue of loans, can be some of the reasons why financial institutions are reluctant to give loans to private entrepreneurs since the former are less risky.

Corruption appears to be the third biggest problems affecting the business operations of firms in Nigeria as perceived by the managers and business owners in the manufacturing industries. it is well documented in the international trade and FDI literatures that corruption is a serious problem because unofficial payments to government officials by private firms add to their cost of operations and as such it constitutes a major obstacle. This also discourages the inflow of quality foreign direct investment into manufacturing sector, the channel through which the productivity of domestic firms can be greatly enhanced and export base boosted. Corruption can also be part of the reasons for extreme protection of domestic firms as the few larger ones tend to continue to dominate the market and dictate prices with less quality. Joining the African Continental Free Trade Area can be a suitable approach to reduce market dominance, encourage quality upgrading and price reduction thereby improving public welfare.

Tax rates and transport constitute the fourth and fifth major obstacles to doing business in Nigeria as considered by the firms. A report by the National Bureau of Statistics on the Nigerian Manufacturing survey from 2010 to 2012 indicates that tax is one of the major expenses of the firms in the manufacturing sector. High tax rates discourage investment in the real sector especially small-scale firms. The issue of bad transportation in Nigeria is not new to all Nigerians and even beyond. This has been one of the major causes of road accidents in the country and that includes Van accidents in the process of delivery goods. Finished goods have to be distributed across the country and raw materials have to be delivered to companies for production. This can be very difficult and has been in the case of Nigeria over the years causing both suppliers and customers to loss substantial amount of money. Good transport is a necessity for smooth operations in the country.

Recommendations

Based on the discussion and findings of this study, it will be good for Nigeria to join the African Continental Free Trade Area (CFTA) due to the enormous benefits that Nigerian businesses stand to get. Given the potentials in the industrial sector, CFTA will help unlock most of these potentials which will facilitate job creation and poverty reduction in the country and the continent at large.

Nigeria must improve the business environment in the country by either removing or substantially reducing the obstacles to doing business that are making it difficult for the firms to grow and compete. Infrastructure development should be improved especially electricity and transport. Government should intensify the fight against corruption and allow easy access to credit by firms by looking for alternative

source of government borrowing rather than resorting to domestic financial markets. Favourable tax regime should be pursued in order to encourage the growth of firms in the country. Hence, the benefits drivable from joining the Continental Free Trade Area will be maximised conditional upon addressing the major obstacles to doing business in Nigeria.

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