Trade, Diversification and Growth in Nigeria

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Abstract

Nigeria's trade policy is at a crucial turning point. Historically, the country has had a very restrictive import regime that generated substantial transfers to domestic producers and strong anti-export bias. Yet, in its current poverty reduction strategy, Nigeria identified deeper trade integration as a means to foster economic growth and alleviate poverty. Border tariffs are being reduced, trade regulations are under review, and ambitious modernization programs for customs services and port infrastructure have been launched. The envisioned reforms involve far-reaching changes to the trade regime that promise to create new opportunities by improving the efficiency of production and consumption, while requiring adjustment of domestic producers to the new, more competitive economic environment.

Keywords

Trade, tariffs, regional integration, preferences, world markets

JEL Classification

F13; F14; F15; O24

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EXECUTIVE SUMMARY

Nigeria's trade policy is at a cross-roads. Historically, the country has had a very restrictive import regime that generated substantial transfers to domestic producers and strong anti-export bias. Yet, in its current poverty reduction strategy, Nigeria identified deeper trade integration as a means to foster economic growth and alleviate poverty. Border tariffs are being reduced, trade regulations are under review, and ambitious modernization programs for customs services and port infrastructure have been launched. The envisioned reforms involve far-reaching adjustments to the trade regime that promise to create new opportunities by improving the efficiency of production and consumption, while requiring adjustment of domestic producers to the new, more competitive economic environment.

Nigeria's export performance has been lackluster. Unlike some other fuel producers, the country has not managed to diversify its economy, so that petroleum continues to account for almost all merchandise exports. This dominance of fuel exports has made Nigeria highly dependent on developments in the world oil market and prevented it from taking advantage of dynamic opportunities in other sectors. Past attempts to foster non-fuel merchandise exports through export subsidies and other incentive measures have had very limited success, as many of the programs have been undermined by fraud. GON should consider to systematically review the existing programs with a view to evaluate their effectiveness in achieving their stated aims, and possibly focus its attention and support increasingly on improvements of the general business climate and domestic supply capacity rather than on particular sectors or companies.

For many years, Nigeria has had one of the highest levels of domestic market protection in the world. High tariffs and pervasive import prohibitions have burdened consumers with high prices and shielded producers from international competition. The regime provided strong incentives to produce for the domestic market, rather than to try and serve international clients. As a result, the productivity and competitiveness of companies remained low and inefficient producers were able to sustain their operations due to high import barriers. In this context, the recent adoption of the ECOWAS common external tariff with its substantially lower duty rates promises to spur productivity growth and make domestic producers more agile in supplying domestic and international markets. GON should further pursue its trade policy reform agenda, including with respect to the modernization of customs and port logistics, and fully implement its commitment to eliminate special tariffs on sensitive products and import bans by the end of 2007.

Reforms in the services sector, such as the liberalization of telecommunications, have been relatively successful and services exports have outpaced non-fuel merchandise exports in recent years. Inflows of foreign direct investment remain highly focused on the fuel sector, but upcoming large-scale privatizations in the transport sector promise to attract the interest of investors from abroad. The continued opening of services sectors will help domestic suppliers to further strengthen their competitiveness and has the potential to turn Nigeria into a net-exporter of services. However, statistics on services sector developments are of mixed quality and only available at a relatively aggregate level, so that any projections should be treated with care.

Further integration at the regional and global level provides Nigeria with an opportunity to reduce policy uncertainty and increase the predictability of its trade regime, which will tend to foster investment and trade relations. Nigerian exporters of non-fuel merchandise have so far not been able to derive significant benefits from preferential market access opportunities in developed countries. In this context, it is important for GON to take an active role in shaping the outcome of the Economic Partnership Agreement negotiations with the EU and the WTO Doha Round in order to maintain and possibly improve the terms of goods and services market access in western Europe, including with respect to rules of origin provisions and trade standards, and bring down existing barriers to Nigeria's exports in middle income countries.

Summary of recommendations

Policy issue	Action recommended	Requirements: Implement policy	Requirements: Change policy	Requirements: Undertake analysis	Time frame
Enhancing export performance					
	Undertake systematic review of the effectiveness of the non-fuel export enhancement grant program.			X	Short term
	Conduct benefit-cost analysis with respect to the incentives provided in Special Economic Zones.			X	Medium term
	Focus export promotion efforts on cross-sectoral improvements of the general business climate.	X	X	X	Longer term
	Enhance quality of market information that is provided to potential exporters.	X		X	Longer term
	Improve status of the country as a safe and pleasant location to attract travellers and foreign investors.	X	X	X	Longer term
Reforming domestic trade policies					
	Reduce anti-export bias by fully implementing the lower duty rates of the ECOWAS-CET.	X			Short term
	Prepare explicit schedule for phase-out of special tariffs and import prohibitions and implement it.		X	X	Short term
	Develop safeguard and anti-dumping measures in accordance with international trade law.		X		Medium term
	Continue privatization program and service sector liberalization to reap benefits from openess.	X	X		Medium term
	Pursue customs and port modernization agenda in order to reduce trade transactions costs.	X	X		Medium term
	Improve quality of trade statistics, including in services trade, to better inform policy decisions.		X	X	Longer term
Furthering integration within the region					
	Monitor informal cross-border trade to better assess its extent and composition.			X	Longer term
	Fully implement ECOWAS trade liberalization scheme, as scheduled.	X			Medium term
	Clarify status of ECOWAS revenue loss compensation entitlement.	X			Short term
	Assume pro-active role in EPA discussions to further national trade interests.		X		Short term
	Press for more favorable EU market access and rules of origin provisions in negotiations on EPA.		X		Short term
Exploiting global market opportunities					
	Take active position in Doha Round to reduce export barriers in middle-income countries.		X		Medium term
	Extend the binding coverage and narrow the binding overhang to augment policy predictability.		X		Longer term
	Make offer in GATS negotiations to anchor domestic services sector reforms.		X		Short term

Note: Short term – within 12 months; Medium term – within 2 years; Longer term – within 5 years.
Source: World Bank staff.

1. Can Economic Integration be an Engine of Competitiveness and Growth?

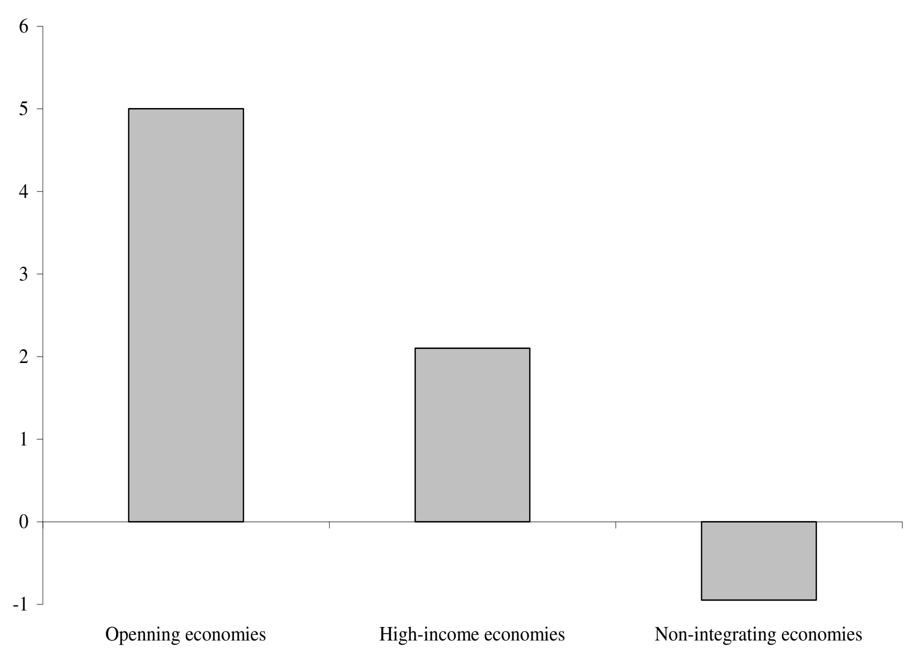
Nigeria's trade policy is undergoing a phase of fundamental changes. Historically, the country has had a very restrictive import regime that generated substantial transfers to domestic producers and strong anti-export bias. Yet, in its current poverty reduction strategy, Nigeria identified deeper trade integration as a means to foster economic growth and alleviate poverty. Border tariffs are being reduced, trade regulations are under review, and ambitious modernization programs for customs services and port infrastructure have been launched. The envisioned reforms involve far-reaching adjustments to the trade regime that promise to create new opportunities by improving the efficiency of production and consumption, while requiring adjustment of domestic producers to the new, more competitive economic environment.

1.1 Openness is supportive of economic development

There is considerable, world-wide evidence that trade integration contributes positively to economic performance (Winters, 2004). Part of the benefits of trade reform depends on other policies and institutions being supportive, so that complementary policy measures should accompany changes in the trade regime. But given that trade liberalization is administratively simple to implement, – indeed a transparent and liberal policy releases administrative resources for other tasks – the case for making trade reform part of a pro-growth policy agenda is strong.

Analysts have measured the degree to which different countries have opened their markets by looking at changes in tariffs and trade-to-GDP ratios over time. Using such an approach, a team of World Bank macroeconomists found that developing countries that pursued an active world market integration strategy achieved annual economic growth of about 5 per cent per capita during the 1990s, i.e. more than twice the level observed in high-income countries. In contrast, developing countries that did not open their economies experienced lower, and on average negative, growth rates (Figure 1).

Figure 1: Market openess and economic growth during the 1990s
(Per cent annual increase in GDP per capita)



Source: Dollar and Kray, 2001.

A number of recent econometric studies indicate that increased exports and imports have indeed had a positive impact on gross domestic product in Nigeria (Akinlo, 2004; Kingsley, Okechukwu and Adenuga, 2004; Nnadozie, 2004; Olufemi, 2004). However, to what extent this trade-generated growth has benefited all spheres of society and notably the poor remains unclear. Near-term poverty impacts of trade liberalization tend to be mixed (Oyejide, 2003; Hertel and Winters, 2005), reflecting the heterogeneity in income sources and consumption behavior across the population. Nevertheless, sustained longer-term poverty reductions depend on raising productivity and stimulating economic growth, to which trade reforms can make a significant contribution.

1.2 Nigeria is a major player in the region

In terms of population, Nigeria is the largest country in Africa and ranks ninth in the world. It is also one of the world's top-10 petroleum exporters and it's proven reserves would make it possible to sustain current export levels for at least another 25 years. Within sub-Saharan Africa, Nigeria's gross domestic product is second only to South Africa's and is bigger than that of the other 14 members of the Economic Community of West African States (ECOWAS) combined. With such a regionally dominant economy, any change in trade policies is bound to have a marked impact on West Africa and beyond. On the other hand, Nigeria's share in world-GDP amounts to less than 0.15 per cent, and its economy is less than half the size of that of small European countries, such as Finland, Ireland or Portugal. Hence, Nigeria is not big enough to influence the global market (except for petroleum), but has to adjust to global trends instead.

Given the country's dominant regional position, it is useful to compare Nigeria's trade performance not only with those of its neighbors and partners in West Africa, but also with a set of peers from other parts of the world that share Nigeria's key economic characteristics, namely being a regionally important, population-rich exporter of petroleum. For this purpose, the most populous petroleum-exporters in each of the World Bank regions were selected as comparator countries, i.e. Egypt (Middle East and North Africa), Indonesia (East Asia), Mexico (Latin America), Pakistan (South Asia), and Russia (Europe and Central Asia). With the exception of Pakistan, all of these five comparators derive more than ten per cent of their total export revenues from fuel (Table 1).

Table 1: Basic characteristics of Nigeria and comparator countries

	Population (mill)	GDP (mill USD)	GDP per capita (USD)	Fuel exports (% of total X)	GCI-Rank * (lower is better)
NIGERIA	139.8	72 106	516	96.4	88
Egypt	68.7	75 148	1 094	43.8	53
Indonesia	217.6	257 641	1 184	25.8	74
Mexico	103.8	676 497	6 517	11.2	55
Pakistan	152.1	96 115	632	2.4	83
Russia	142.8	582 395	4 078	53.0	75

Note: Data for 2004 (or latest available). *) GCI = Growth Competitiveness Index 2005/06.
Source: World Bank (2005), World Economic Forum (2005).

All the five international comparators have a larger economy than Nigeria and boost higher per capita incomes. They also have more diverse export structures and receive more favorable growth competitiveness rankings in the most recent annual assessment of the World Economic Forum. Hence, they show features that Nigerian policy makers should find attractive to aspire to. There are, of course, other countries that might provide valuable case studies for designing trade strategies that strengthen competitiveness and economic growth, but the following discussion focuses on the five listed comparators.

1.3 Forward-looking policies can help to grasp opportunities

Like most policies, trade reforms are associated with winners and losers, at least in the short run. In this context, it is essential for policy makers to have a good understanding of the direction and magnitude of the impacts of existing and prospective policy programs on different economic sectors and societal groups. This information will make it possible to design complementary policies that maximize the benefits from reform, while limiting adverse effects on incomes and employment. Such carefully designed and sequenced reform programs have significantly higher chances of being sustained over time and to contribute substantially to the objective of promoting broad-based economic growth and poverty alleviation.

The analysis in the following aims to contribute to the policy dialogue by describing and evaluating recent and prospective trade policy developments at the unilateral, plurilateral and multilateral level in the context of Nigeria's growth and competitiveness agenda. The discussion will thereby be comprehensive, covering both merchandise (agriculture, fuels & mining, and manufacturing) and services trade, and try to quantify the impacts of existing policies and reforms, as far as this is possible. The findings will be related to the performance of a consistent set of comparator countries in order to put them into a broader perspective.

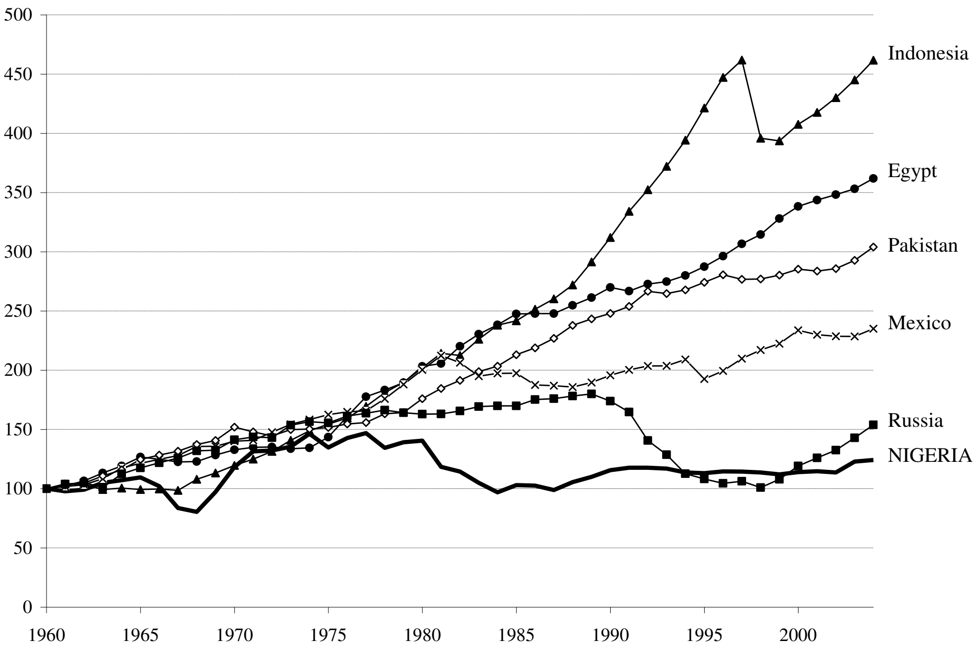
The remainder of the chapter falls into five parts: First, Nigeria's recent trade performance will be discussed, with special attention to experiences and prospects of export diversification. Second, domestic trade policies and their effects will be examined in order to identify priorities for growth-enhancing reforms. Third, Nigeria's regional integration agenda will be described and assessed, with particular emphasis on the impacts of further integration within ECOWAS and the negotiations of an Economic Partnership Agreement with the European Union. Fourth, the effects of trade policy changes at the multilateral level, notably those occurring in the context of the Doha Round of WTO negotiations, will be analyzed. And finally, the impacts of the ongoing trade reforms on income distribution and poverty levels are briefly assessed.

2. HOW HAS NIGERIA PERFORMED IN THE INTERNATIONAL ECONOMY?

Nigeria's long-term economic performance has been lackluster. Since 1960 – the year in which the country gained independence – real per capita incomes have risen on average by 0.5 per cent per year, so that the level of incomes increased by barely a quarter during the 45 years. This gain falls clearly short of the income increases in comparator countries, with Egypt, Indonesia and Pakistan more than tripling or quadrupling their per capita incomes over the same period (Figure 2).

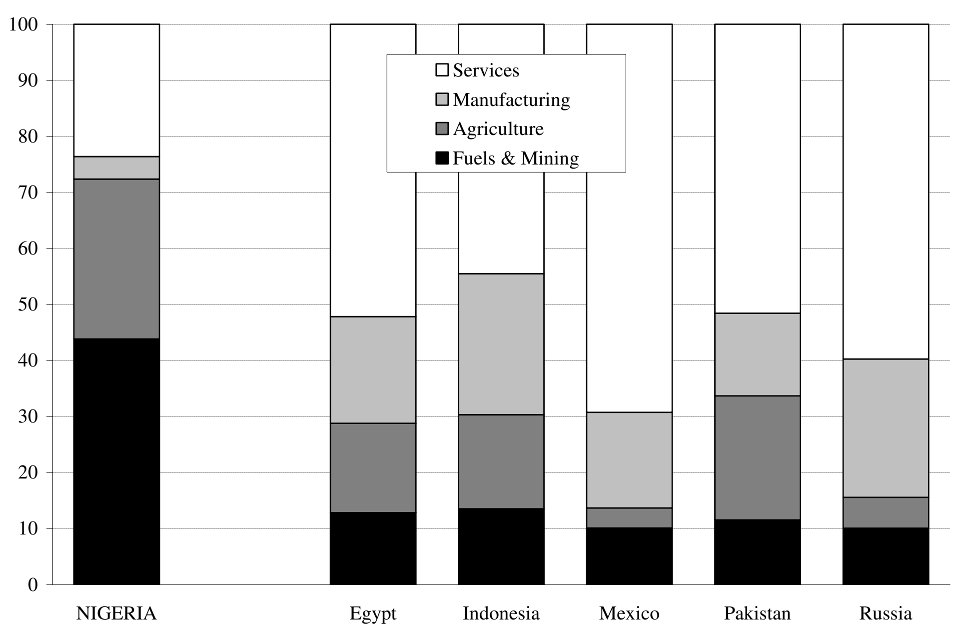
Nigeria's economy remains highly dependent on primary activities. The fuels and mining sector accounts for almost 45 per cent of GDP, and agriculture for another quarter of the economy's value-added. The primary sector is thereby substantially bigger than that of comparator countries (Figure 3). The manufacturing and services sectors, in turn, are very small by international comparison.

Figure 2: GDP per capita
(constant 2000-USD, 1960 = 100)



Note: For Russia, data prior to 1989 refer to the Soviet Union.
Source: World Bank (2005).

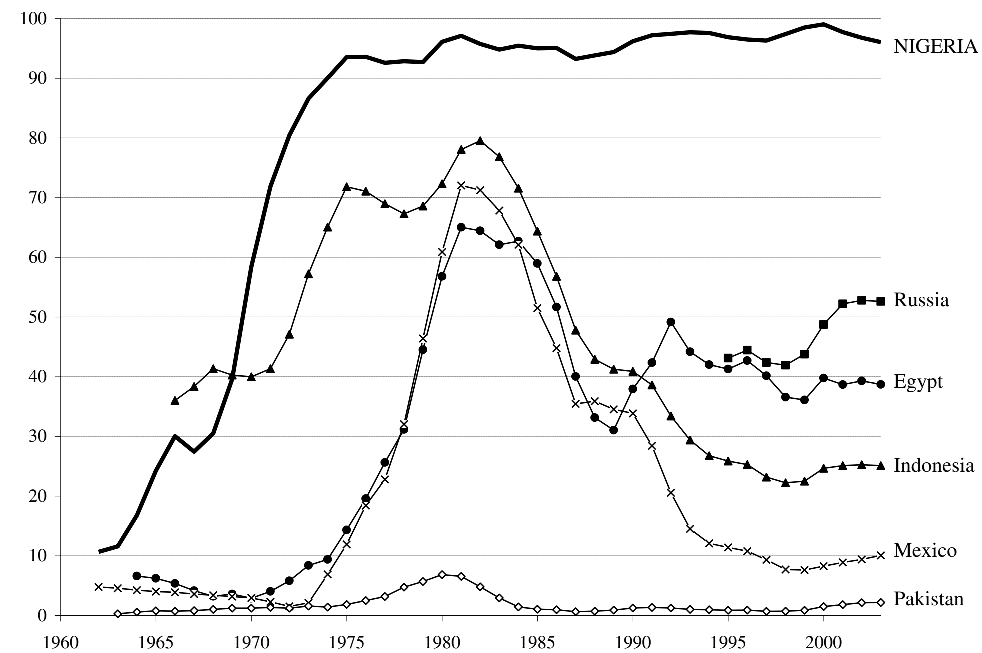
Figure 3: GDP by sector of activity, average 2001-03
(per cent)



Source: United Nations Statistics Division, National Accounts Database.

The strong reliance on primary activities and notably the oil and gas sector is a direct corollary of Nigeria's rich natural resource endowment, which has made it possible for the country to produce and export large quantities of fuels since the 1970s. While in the early 1960s over 80 per cent of Nigeria's total exports was made up of agricultural commodities, such as oil palm products (palm oil, palm kernels and palm kernel oil), groundnuts, cocoa, cotton, rubber, and timber, by the early 1980s more than 95 per cent were accounted for by petroleum. And unlike other major oil producers, Nigeria has subsequently not managed to (re-)diversify its economy, so that petroleum continues to account for almost all merchandise exports. This has made the country highly dependent on developments in the world oil market and inhibited it from taking advantage of dynamic opportunities in other sectors. By contrast, Indonesia and Mexico, for example, reduced their export dependence on petroleum from more than 70 per cent in the early 1980s to 25 per cent or less today (Figure 4), and have enjoyed strong economic growth in the process.

Figure 4: Share of fuel exports in total merchandise exports
(three-year moving average, per cent)



Source: World Bank (2005).

While many factors contribute to a country's production and export performance, studies that compare, for example, Nigeria's and Indonesia's economic and trade policies point to the fundamental importance of good macroeconomic management for success (Pinto, 1987). Indonesia actively adjusted in response to external shocks, and followed prudent fiscal policies, focusing public investments on agriculture and infrastructure in rural areas. Flexible macroeconomic policies allowed Indonesia to convert the wealth from primary exports into sustainable development in other sectors. Nigeria, on the other hand, passively waited until a crisis forced a devaluation. Moreover, large-scale public investments in projects with poor long-run returns, mainly in urban areas, shifted the terms of trade in favor of non-tradables, thereby severely undermining agricultural production and exports (Harrold, Jayawickrama, and Bhattasali, 1996).

2.1 Trade plays a prominent role in the economy

In 2004, the share in GDP of imports plus exports of goods and services amounted to 86 per cent in Nigeria. This ratio is remarkably high for a country of Nigeria's size and exceeds the corresponding trade shares in the five comparator countries. The prominent trade-to-GDP ratio is largely the result of Nigeria's characteristic of being a specialized commodity exporter. As production is concentrated on relatively few products, notably petroleum products, trade is a means of validating domestic surpluses.

Nigeria has enjoyed a sizable current account surplus in recent years, which according to Central Bank statistics amounted to more than 20 per cent of GDP in 2004 (Table 2). In addition to oil exports, strong remittance inflows contributed significantly to the surplus (Box 1). Also, the services trade deficit has almost been cut by half since 2001, while investment income has remained a relatively stable debit item.

Table 2: Current account balance

	2000	2001	2002	2003	2004
	in million NGN				
Goods	1 059 203	766 963	571 285	1 567 454	1 669 284
Exports	1 945 723	2 001 231	1 882 668	2 924 135	3 143 802
Oil and gas	1 920 900	1 973 222	1 787 622	2 829 042	3 030 067
Non-oil	24 823	28 009	95 046	95 093	113 735
Imports	- 886 520	-1 234 268	-1 311 383	-1 356 681	-1 474 518
Oil and gas	- 198 736	- 215 475	- 240 065	- 342 898	- 273 558
Non-oil	- 687 784	-1 018 794	-1 071 318	-1 013 783	-1 200 961
Services	- 149 222	- 332 175	- 289 133	- 289 662	- 216 963
Credit	186 406	183 896	304 312	448 804	443 315
Debit	- 335 628	- 516 072	- 593 445	- 738 466	- 660 278
Trade balance	909 981	434 787	282 152	1 277 793	1 452 321
Investment income	- 362 413	- 343 891	- 382 725	- 423 992	- 436 804
Current transfers	165 456	152 005	170 410	200 834	359 254
General government	- 7 675	6 244	- 1 464	- 10 485	- 8 035
Remittances	173 130	145 761	171 874	211 319	367 289
Current account	713 024	242 901	69 838	1 054 635	1 374 770
	in per cent of GDP				
Goods	21.8	13.9	8.9	25.1	25.0
Exports	40.0	36.2	29.4	46.7	47.2
Oil and gas	39.5	35.7	27.9	45.2	45.5
Non-oil	0.5	0.5	1.5	1.5	1.7
Imports	-18.2	-22.3	-20.5	-21.7	-22.1
Oil and gas	-4.1	-3.9	-3.8	-5.5	-4.1
Non-oil	-14.1	-18.4	-16.7	-16.2	-18.0
Services	-3.1	-6.0	-4.5	-4.6	-3.3
Credit	3.8	3.3	4.8	7.2	6.7
Debit	-6.9	-9.3	-9.3	-11.8	-9.9
Trade balance	18.7	7.9	4.4	20.4	21.8
Investment income	-7.4	-6.2	-6.0	-6.8	-6.6
Current transfers	3.4	2.8	2.7	3.2	5.4
General government	-0.2	0.1	0.0	-0.2	-0.1
Remittances	3.6	2.6	2.7	3.4	5.5
Current account	14.7	4.4	1.1	16.9	20.6

Source: Central Bank of Nigeria.

Box 1: Remittances and the management of migration

Nigeria ranks among the top-20 recipients of remittances in the world, with transfers amounting to 2.8 billion USD in 2004. Hence, remittances from Nigerians residing abroad are an important economic factor. In fact, Balance of Payment statistics might understate the extent of remittances, as they are based on formal transactions only, while many temporary or permanent migrants prefer informal means for sending money back home. Indeed, a survey of the Nigerian Diaspora in Belgium revealed that 55 per cent of remittances go through informal channels (World Bank, 2006a).

Remittances are a form of services exports if they orginate from temporary movement of natural persons. Their impact on household income and poverty alleviation can be significant, so that migration is often a welcome means of achieving a decent income. Yet, the question whether remittances have advanced the longer term development prospects of low income countries is being controversially discussed. Some observers have argued that skilled labor resources are being lost, that remittances have been channeled into consumption rather than productive investment, and that the skills of migrants – if they ever return – have rarely matched local labor market needs. Others have pointed to veritable booms in the construction and hospitality sectors in some emigration-prone countries, and claim that the broader professional experiences of returning migrants have been a boon for diversifying the domestic economy and for fostering new trade links with the former host countries.

It is in any case difficult to ensure that a person working abroad returns to her/his country of origin. The brain drain of health services providers in Nigeria is a good illustration of this problem. About 9 per cent of the physicians trained in Nigeria are now practicing either in Canada or the United States; leaving the country with a ratio of 27 physicians per 100 000 inhabitants – compared with 549 and 210 per 100 000 inhabitants, respectively, for the two receiving countries. More than a third of all physicians of African origin in the US are from Nigeria. Similar flows are noticeable for nurses, with Nigeria being the main African contributor to the pool of foreign-educated nurses in the United States.

Country of origin of African-trained physicians practicing in Canada and the USA, 2002

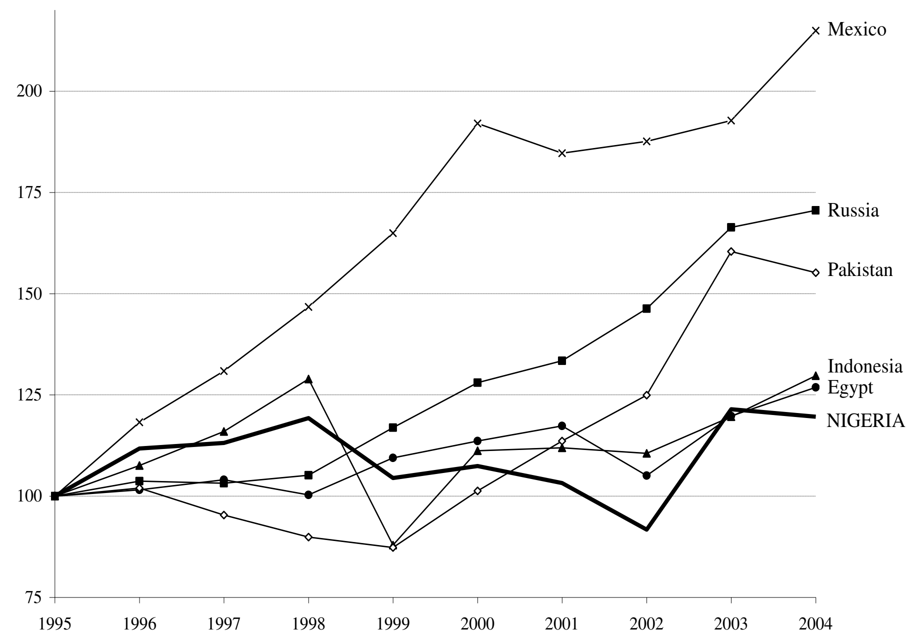
Country of origin	Number of African-trained physicians in Canada	Number of African-trained physicians in USA	Number of physicians remaining in home country	Per cent of total African-trained physicians now in CAN & USA
NIGERIA	123	2 158	22 894	9
Ethiopia	9	257	1 564	15
Ghana	37	478	1 210	30
Kenya	19	93	4 001	3
Liberia	8	47	72	43
South Africa	1 845	1 943	23 844	14
Uganda	42	133	722	20
Zambia	7	67	676	10
Zimbabwe	26	75	1 694	6
Other 12 countries	35	83	12 912	1
Total/Average	2 151	5 334	69 589	10

Source: Hagopian et al., 2004.

When unmanaged, such outflows of specialized staff can contribute to increased health personnel shortages in the origin country. As a response to similar challenges, other developing countries, such as the Philippines, have developed a strategy to actively tap into the important trade potential by setting up institutes to specifically train nurses for the US market. As a result, the Philippines have become an exporter of health services through temporary or permanent movement of skilled personnel. Studies show that developed countries' needs for health personnel will continue to grow substantially. A management strategy of service providers flows, similar to the Philippines model, could therefore also be beneficial to developing countries in Africa, including Nigeria.

Over the past decade, the value of goods and services exports from Nigeria has grown by about 20 per cent in real terms (Figure 5). However, this expansion falls short of the acceleration of the external sector in all of the five comparator countries, as well as the world overall (export growth of more than 70 per cent). Hence, Nigeria has been losing world market share.

Figure 5: Growth in exports of goods and services
(Constant 2000-USD, 1995 = 100)



Source: World Bank (2005).

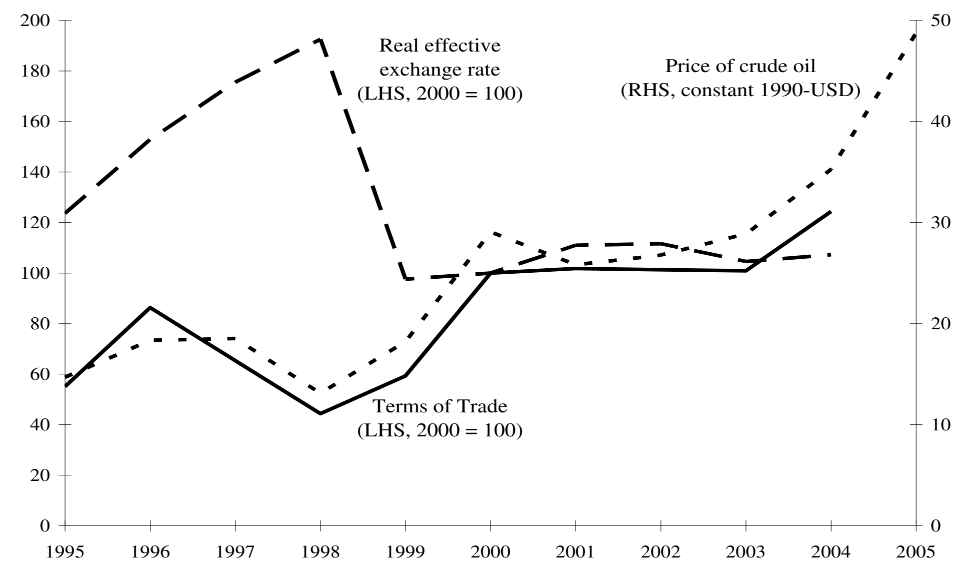
The large foreign currency inflows due to fuel exports means that the Naira has been strong.[1] This makes imports relatively cheap, while presenting domestic producers with a competitive challenge. Nigeria has been operating a multiple exchange rate regime, but the Central Bank is moving towards the unification of rates and hopes to achieve this aim during 2006. This step would eliminate the artificial wedge between import and export prices and help to spur trade.

After fluctuating markedly during the late 1990s, Nigeria's real effective exchange rate has been relatively stable since 1999 (Figure 6). In parallel, Nigeria's terms of trade, which are largely determined by world petroleum prices, have improved. As world demand and prices for oil continue to be strong, Nigeria is bound to benefit from further gains in its terms of trade.

Nearly half of Nigeria's merchandise exports are destined for North America and almost another quarter for Western Europe. East Asia and Latin America account for 10 per cent each, while sub-Saharan Africa is the destination of about 7 per cent of Nigeria's shipments. For non-fuel exports, which account for about 4 per cent of the total, Western Europe is by far the most important destination, accounting for 70 per cent of the total (Figure 7). It should be noted, though, the official trade data on flows with neighboring countries do not cover informal trade, which is substantial, and hence lead to an underestimation of the importance of African trade links.

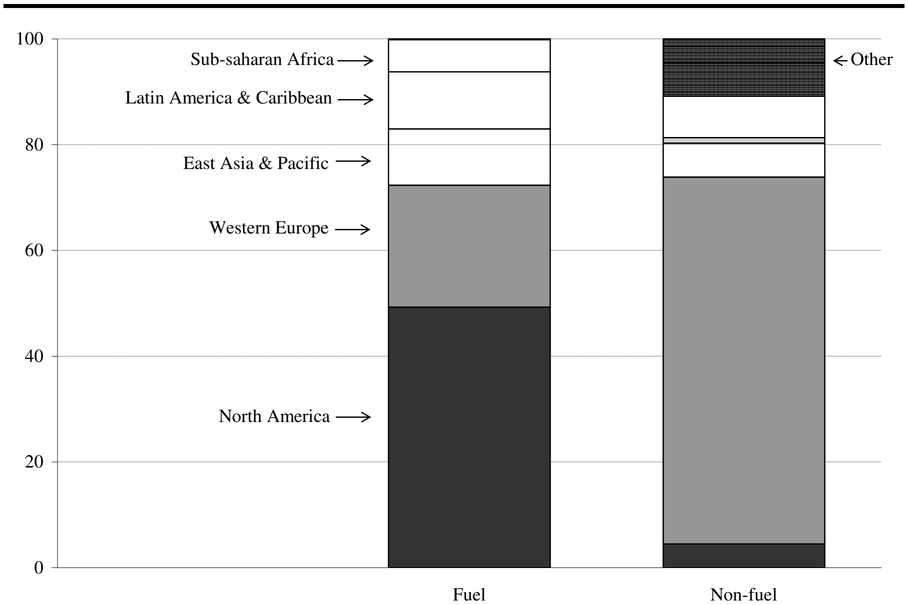
[1] See the separate CEM-chapter on exchange rate policy for a detailed discussion of related issues.

Figure 6: Developments in the real exchange rate and terms of trade



Notes :
a) Real effective exchange rate is the nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator.
b) Terms of trade are the ratio between export prices and import prices.
c) The crude oil price is taken as the average of Brent and West Texas Intermediate deflated by the G-5 manufactures unit value index.
Source: World Bank.

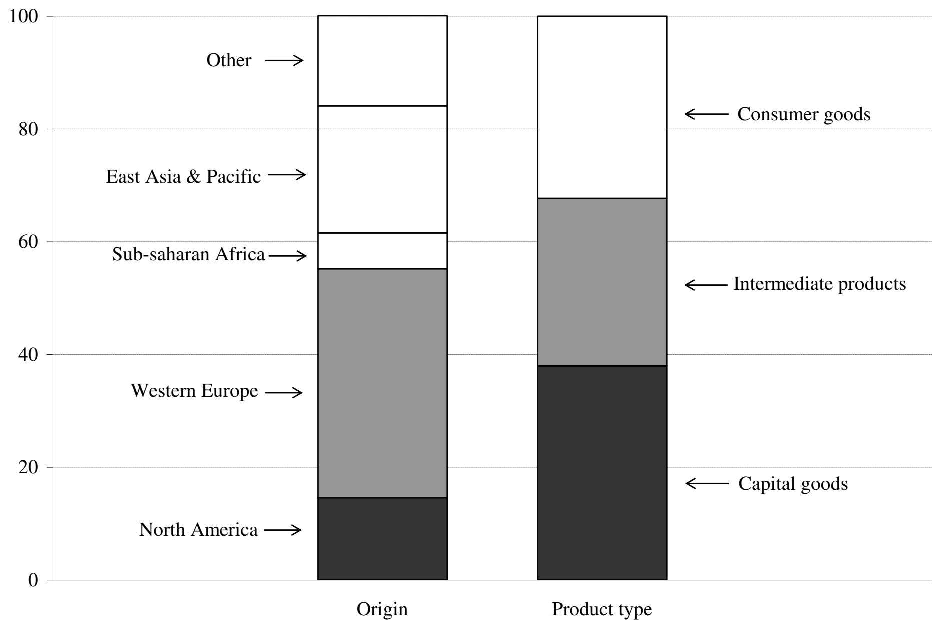
Figure 7: Regional destination of merchandise exports
(average for 2002-2004, per cent)



Note: Information based on mirror data, i.e. information from other countries on imports of Nigerian products.
Source: World Bank staff based on data from the Federal Office of Statistics.

Regarding imports, capital goods account for nearly 40 per cent of the total, while intermediate products and consumer goods each have a share in imports of about 30 per cent (Figure 8). With respect to the origin of imports, more than 40 per cent of all imported goods comes from Western Europe and almost a quarter from East Asia. The asymmetric structure of trade, with North America being the largest destination of exports and Western Europe the largest source of imports, means that a potential devaluation of the US dollar against the Euro would tend to worsen Nigeria's export to import price ratio and offset some of the terms of trade gains that have recently accrued to the country due to the rise in world oil prices.

Figure 8: Origin and structure of merchandise imports
(average for 2002-2004, per cent)



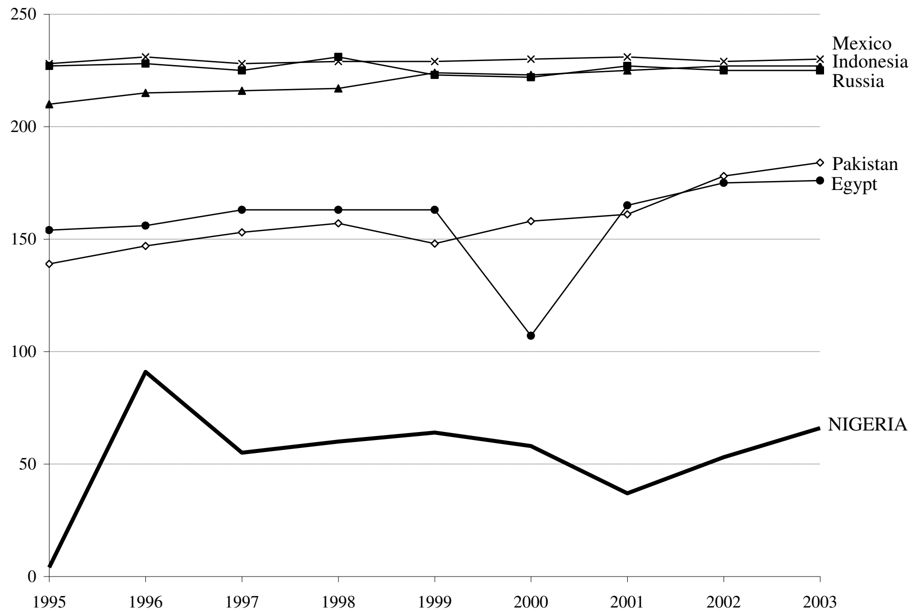
Source: World Bank staff based on data from the Federal Office of Statistics.

2.2 Attempts to diversify merchandise exports have yet to yield results

There is substantial evidence that export diversification and economic growth are positively related in low income countries. Feenstra and Kee (2004) constructed an export variety index and found in their cross-country analysis a positive correlation between the index value and industry productivity. Also, Hausmann, Hwang, and Rodrik (2005) established a positive relationship between the mix and sophistication of a country's exports and subsequent economic growth. Earlier, Imbs and Wacziarg (2003) had used various measures of sectoral concentration to show that countries in the development process first diversify by spreading activities more equally across sectors, before specializing again at a relatively high income level. Concentration hence follows a U-shaped pattern.

Nigeria's merchandise exports are largely dominated by fuels. Indeed, if measured by widely-used indicators such as the Herfindahl index, which is calculated as the sum of the squares of product export-shares, Nigeria is the country with the most highly concentrated export structure in the world (UNCTAD, 2005b). In 2003, the country had only 66 product groups (up from 37 in 2001, though) with export values exceeding USD 100 000, while each of the five comparator-countries had substantial exports in at least 175 product categories (Figure 9). On a per capita basis, only three countries in the world have lower non-oil merchandise exports, namely Burundi, Ethiopia, and Rwanda (Nielsen, 2005). The dependance on fuels might even increase further in the medium term, as exports of natural gas, of which Nigeria has very substantial reserves, are projected to double within the next four to five years.

Figure 9: Number of product-groups with substantial exports

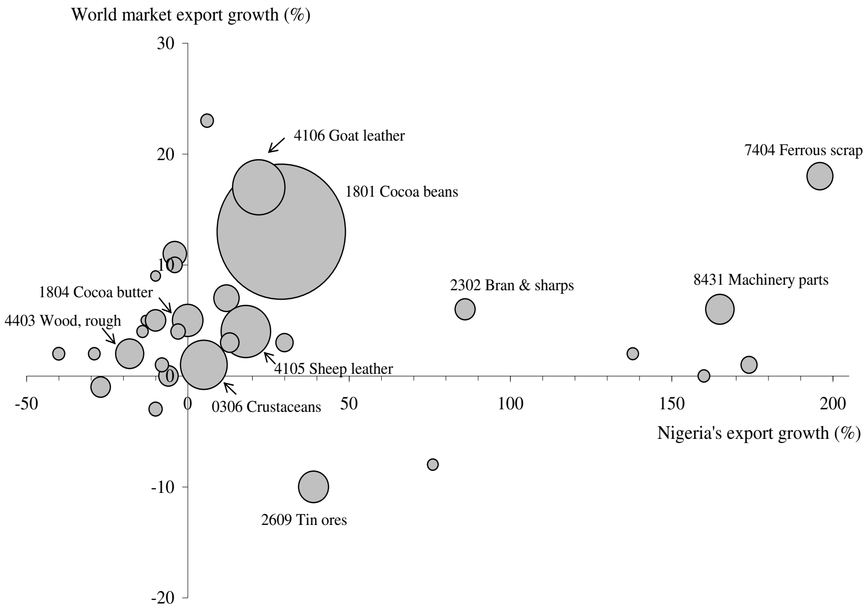


Note: Product-groups defined according to SITC Rev.3 at the 3-digit level. Substantial exports are taken as product-groups with customs values exceeding USD 100 000.
Source: UNCTAD (2005b).

It should be noted that Nigerian trade statistics on non-oil exports appear to be highly incomplete and inconsistent (while fuel trade seems to be more accurately measured). Other countries report non-oil imports from Nigeria that are on average five times as large as the exports reported by the Nigeria Customs Service and the Federal Office of Statistics (in contrast, the balance of payment information published by the Central Bank of Nigeria seems to provide a good representation of trade flows). While export and import flows should not be expected to match perfectly due to pricing differences (fob *versus* cif), loss in transport, and goods in transit at the turn of the year, the observed discrepancies can not be explained through these factors. An extreme example is 2001, when foreigners reported non-oil imports from Nigeria that exceeded the origin country's reported exports by a factor of almost thirteen. Since import statistics are generally more reliable than export statistics due to the greater scrutiny in the importing process, the following discussion uses mirror data whenever possible to analyze Nigeria's non-oil exports.

During the five-year period from 1999 to 2003, Nigeria's main non-oil merchandise exports, i.e. cocoa beans, leather, and crustaceans, expanded faster than the world market overall. But in other non-oil export categories the picture is mixed and exports appear to be rather volatile. For example, growth in several product categories, such as bran & sharps, machinery parts and ferrous scrap, far outpaced world market growth, while in many other categories export growth stalled or was even strongly negative (Figure 10). These strong variations seem to be related to the low absolute value of exports in the respective categories, so that small increases or decreases in export volumes can generate large relative changes.

Figure 10: Non-fuel merchandise export growth by product-group, 1999-2003
(change in USD-value of exports, per cent)

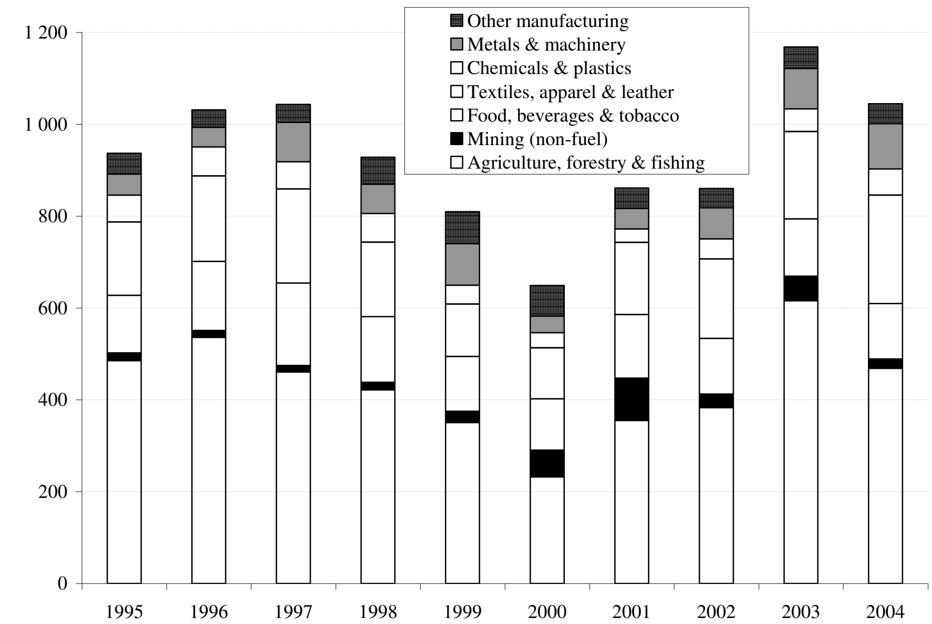


Note: Product-groups defined at the HS 4-digit level. Export values derived from mirror data (import data in destination countries). The circle area is proportional to the value of exports.
Source: World Bank staff based on data from the International Trade Center.

Over time, fluctuations in non-fuel exports have largely been driven by changes in agricultural commodity exports (Figure 11). Overseas shipments of manufacturing products have been more stable, and shown some modest expansion recently. Over the five-year period 1999-2003, manufacturing exports grew by an annual average of 2.8 per cent in nominal USD-terms, and during 1999-2004 by an annual average of 4.2 per cent. The biggest share of the expansion was thereby due to processed skins and leather products. Also, the textiles and leather industry showed by far the highest exports per employee ratio within the manufacturing sector in 2002 (Table 3) and it was the only manufacturing branch that was a net exporter of its products (though it became a net importer in 2003).

Concerning the technology content of manufacturing exports, Nigerian products that are shipped abroad are not very sophisticated. The share of medium and high technology products accounts on average for about 20 per cent of non-fuel manufacturing exports (Figure 12). This share is lower than the corresponding ratio in all comparator countries, except Pakistan. Over time, the share of low technology products has grown in Nigeria at the expense of resource-based manufacturing, reflecting the expansion of exports of processed skins and leather products.

Figure 11: Non-fuel merchandise exports by sector
(in million current USD)



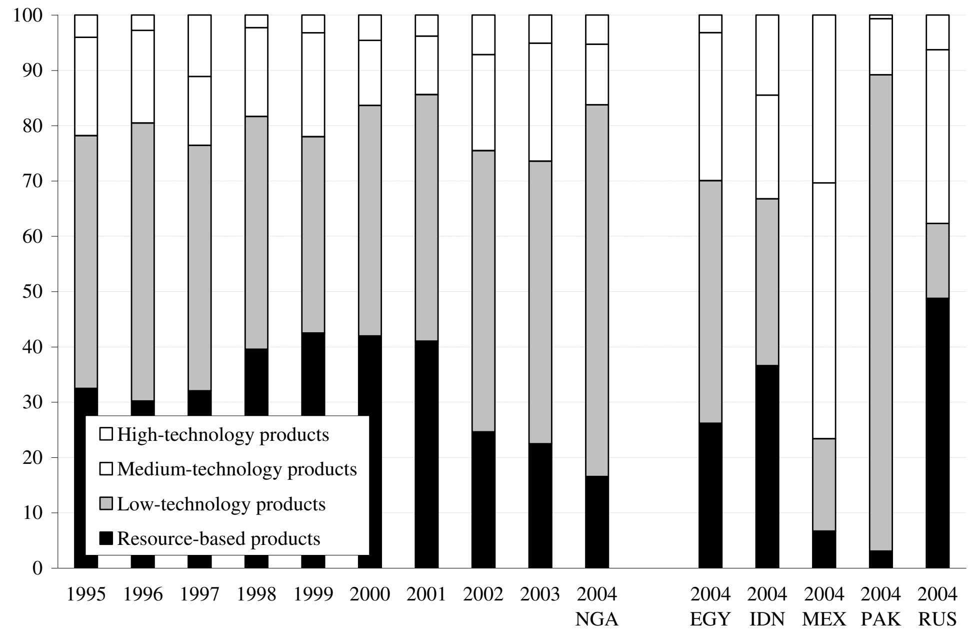
Note: Information based on mirror data, i.e. information from other countries on imports of Nigerian products. Data for 2004 are provisional, as not all countries have reported their import data to the Comtrade database. Product groups aggregated from ISIC Rev. 3 classification.
Source: World Bank staff based on UN Comtrade database.

Table 3: Structure of non-fuel manufacturing in Nigeria, 2002

	Exports mn USD	Imports mn USD	Net exports mn USD	Value-added mn USD	Employ-ment '000	Exports/ Employee USD
Food, beverages & tobacco	121	1 374	-1 253	345	372	326
Textiles, apparel & leather	173	117	56	188	80	2 152
Wood & products	26	80	-53	234	166	160
Paper & publishing	2	296	-293	157	153	14
Chemicals & pharmaceuticals	39	1 479	-1 440	28	143	272
Rubber & plastics	5	184	-179	57	94	54
Non-metallic minerals	3	376	-372	42	148	21
Metals & machinery	34	2 062	-2 028	234	76	448
Electrical & electronic products	23	979	-955	29	87	269
Vehicles & transport equipment	10	1 224	-1 214	223	76	135
Total Manufacturing	438	8 169	-7 731	1 537	1 395	314

Source: UN Comtrade database for trade (mirror data for exports), UNIDO for manufacturing value-added, and Manufacturers Association of Nigeria (2004) for employment.

Figure 12: Technology content of non-fuel manufacturing
(in per cent)



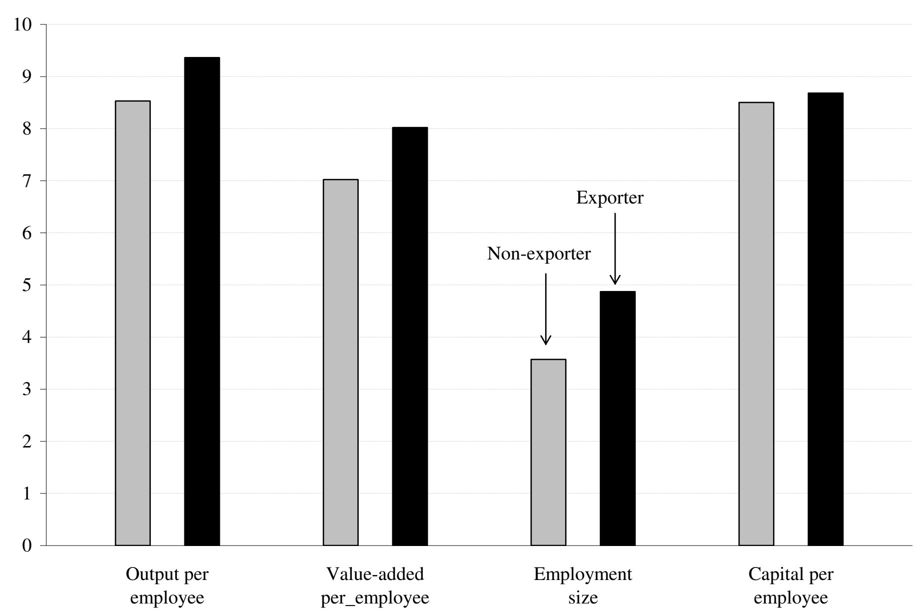
Note: Information based on mirror data, i.e. information from other countries on imports of Nigerian products. Data for 2004 are provisional, as not all countries have reported their import data to the Comtrade database. Technology content classification based on UNIDO (2005).
Source: World Bank staff based on UN Comtrade database.

Some analysts have suggested that the slow pace of non-traditional export growth and diversification in developing countries is due to market failures that cause a lack of "product discovery", i.e. the uptake and export of products that have not been previously supplied by firms in the country (Hausmann and Rodrik, 2003). Firms underinvest in the discovery process because once the entrepreneur identifies a new profitable product for export, others can easily imitate the innovator's success, free-riding on the initial investments in experimentation and staff training and driving down the innovator's profits. Klinger and Lederman (2004) develop an approach to analyze the emergence of new export products empirically. They define a product discovery as the growth of exports in a product category from less than USD 10 000 in each of three base years to more than USD 1 million in each of three target years.

If this methodology is applied at the SITC 4-digit level to the ten-year Nigerian export development between 1993-95 and 2002-2004, only one product discovery ("Liquefied natural gas") is found. And in case the stringency of the criteria is lowered by reducing the target year threshold from USD 1 million to USD 100 000, only two additional products are identified ("Waste and scrap of paper or paperboard", and "Waste and scrap of cast iron"). None of these discoveries represents a productive non-fuel output. In comparison, Klinger and Lederman found in their sample of 53 countries an average product discovery rate (at the HS 4-digit level) of more than six per country. Hence, there seems indeed to be a deficit in Nigeria with respect to the uptake of new productive activities. One means for governmental authorities to help the discovery process and overcome possibly existing information and coordination deficiencies would be to assist potential exporters in identifying new overseas opportunities by providing better developed and targeted market and industry information than is currently available to them.

Another pertinent issue relates to the question which characteristics make companies more susceptible towards exporting. A team of researchers recently surveyed 145 manufacturing firms in Nigeria in order to determine the characteristics of exporters *versus* non-exporters (Rankin, Söderbom and Teal, 2004). They found in their sample that the propensity of Nigerian firms to export was substantially lower than that of firms in other countries they studied, namely Ghana, Kenya, South Africa, and Tanzania. But similar to these other countries, exporters tended to be more productive in terms of output or value-added per employee than non-exporters and be larger in terms of employment size and capital stock (Figure 13). In addition, exporting firms were on average established for a longer time and were more likely to have some foreign ownership. These findings suggest that export promotion policies should focus on measures to remove fiscal and regulatory obstacles to enterprise growth and support investments in human and physical capital in order to foster productivity increases.

Figure 13: Characteristics of exporters and non-exporters
(values in natural logarithms)



Note: Data based on a sample of 145 manufacturing firms in Nigeria that included 13 exporters and 132 non-exporters.
Source: Rankin, Söderbom and Teal, 2004.

The extraordinary dependence of Nigeria's economy on petroleum, which is a non-renewable resource, makes economic diversification a high policy priority. GON seems well aware of the risks and disadvantages of the country largely being a single commodity exporter, and there has been no shortage of desire to promote non-oil exports in Nigeria. The current National Export Strategy envisages annual growth rates for non-oil export earnings that accelerate stepwise from 25 per cent in 2005 to 50 per cent in 2010. By that time, the government's Vision 2010 calls for non-oil exports to account for 38 per cent of all merchandise shipped abroad (Nigerian Export Promotion Council, 2004).

Judging by past performance, these goals appear ambitious. Nigeria has pursued a number of initiatives to encourage non-oil exports in the past. Special Economic Zones have been devised to provide investors with a more favorable business environment than is available on the mainland, but the uptake of the incentives provided has so far been rather disappointing

(Box 2). Moreover, Nigeria used to operate duty drawback systems, which made it possible for exporters to claim refunds on imports of production inputs, as well as manufacturing-under-bond and bonified-manufacturers schemes, which allowed duty-free imports. But due to large-scale abuse, these systems were discontinued in 2002 and 2005, respectively.

Box 2: The Calabar Free Trade Zone

After putting legislation on the establishment of special economic zones (SEZ) into place in 1992, Nigeria's first SEZ at Calabar, the southeastern port city and regional capital of Cross River State, became operational in 1999. Since then other States have started to establish similar zones to foster local and foreign investments by providing business-friendly environments in spatially confined areas. But by the end of 2005, only one other zone, namely Onne Free Zone near Port Harcourt, was operational.

Enterprises in the SEZs enjoy a number of administrative and fiscal advantages. These include one-stop approvals for permits, operating licenses and incorporation papers. Moreover, tax exemptions from Government taxes and levies are granted and SEZ-firms can import raw materials and components for goods destined for re-export tax and duty-free. After the initial uptake by companies remained unsatisfactory, the existing export processing zones were transformed into free trade zones in 2001 by abrogating the rule that companies located in the zone should export at least 75 per cent of their production (Nielsen, 2005). Since then, firms are allowed to sell up to 100 per cent of manufactured, assembled or imported goods into the Nigerian market, but if they are serving the domestic market, they are subject to payment of the import duty on the raw materials or components used in assembly of the finished products.

The Onne Zone with it's about 100 firms, which are employing about 7 000 workers, is largely dedicated to the facilitation of liquefied natural gas exports. Activities in the Calabar Free Trade Zone are more diversified, including food processing, furniture production, packaging, rubber processing, and iron works. By the end of 2005, there were 23 companies operating in the Zone. Half of these firms are wholly foreign-owned, while the remaining ones have local capital participation or are completed controlled by Nigerians. Total investment amounted to about USD 350 million and employment stood at about 2 000 workers, with the food, packaging and basic metal industries accounting for three-quarters of the total. In 2003, Calabar exported about USD 50 million of products.

It is difficult to assess the performance and impact of the Calabar Free Trade Zone to date, as the zone is still in its build-up phase and there are only very limited data on production and exports available. Looking at world-wide experiences, the potential role of SEZs as engines of growth in developing countries has been a much discussed topic. Individual country experiences with export processing zones have been mixed and the specific set-up and management of the zones seems to be paramount to their success. In particular, good governance seems crucial for a country's success in setting up SEZs.

Export processing zones can make a positive contribution to growth and employment if they manage to attract foreign direct investment that is accompanied by technological transfer, knowledge spillovers and backward linkages to suppliers in the mainland. Relatively successful examples in terms of the dynamics of economic activity and employment include Honduras, El Salvador, Mauritius, China, Indonesia, Malaysia, South Korea, and Sri Lanka. On the other hand, there are a number of failures, and the fact that in most cases firms locating in SEZs enjoy tax breaks and subsidized infrastructure has been prone to criticism. It is indeed not clear whether such incentives can always be justified on a cost-benefit basis (Madani, 1999). For example, detailed analysis suggests that governmental infrastructure investments in the SEZ in the Philippines have not been justified by the returns in terms of employment, tax receipts and foreign exchange earnings (Jayanthakumaran, 2003). In Africa, many SEZs have suffered from lack of socio-political and economic management skills that have not made it possible to address the multiple challenges of SEZ-establishment, such as providing high quality infrastructure, government services, and human capital (Watson, 2001).

Other export incentive programs include the export adjustment fund, which compensates companies for cost disadvantages related to infrastructure deficiencies, the export development fund, which provides financial assistance for international marketing, and the Nigerian Export-

Import Bank, which offers commercial bank guarantees and direct lending to facilitate exports. Yet, the most prominent export incentive system that has been used in Nigeria in evolving forms since 1986 is the export expansion grant (EEG) program. This program subsidizes exports of qualifying companies through the issuance by Customs of negotiated certificates that can be redeemed against duties on imports. Such export subsidy schemes are in conformity with provisions under the WTO Agreement on Subsidies and Countervailing Measures for countries with per capita incomes of less than USD 1 000.

Originally, the EEG accorded export subsidies of 10 per cent to producers of finished goods, but the subsidy was increased over time and reached 40 per cent by 2002. At the same time, agricultural exporters became entitled to a 5 per cent export subsidy. Given the magnitude of these incentives, it is both surprising that there does not seem to have been a strong supply response from actual and potential exporters and that the effectiveness of the program apparently has never been thoroughly assessed. No account of the total volume of export expansion grants is publicly available. But if the 40 per cent rate is applied to the value of exports of textile articles and hides & leather and the 5 per cent rate to agricultural exports, the fiscal cost of the program can be estimated as amounting to about NGN 15.6 billion (USD 117.8 million) in 2004 alone. This is likely to be a lower boundary for the cost of the program, because products in other categories might have qualified as finished goods and benefited from export subsidies.

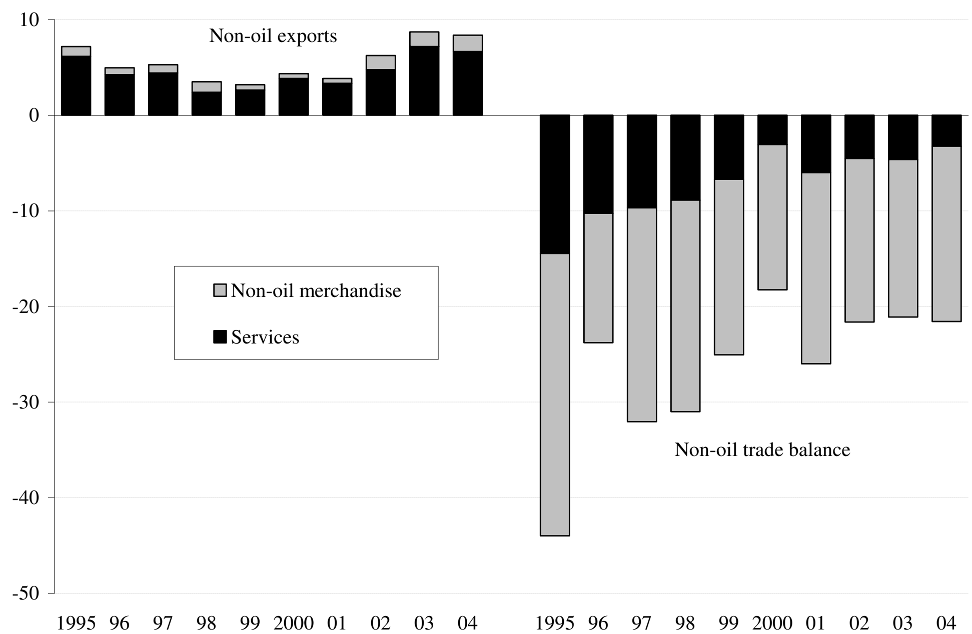
The generosity of the EEG program and the lack of controls gave rise to wide-spread fraud, such as the over-invoicing of exports. In response, the GON reformed the program at the beginning of 2005 by reducing the maximum subsidy-rate to 30 per cent for manufacturing exporters (15 per cent for commodity exporters, 10 per cent for merchants) and tightening the eligibility criteria. In particular, the subsidy-rate has been made dependent on company characteristics, notably local value-added, local content, employment level, sector of activity, export growth, and investment rates. But still, there does not seem to be a regular mechanism in place to evaluate the use of the EEG funds and to assess if and to what extent the program achieves its stated objective. More generally, a broader review of export incentive schemes would seem highly desirable in order to rationalize the government's support to exporters, improve its efficiency, and minimize the risk of abuse.

In countries with fragile governance cultures, pro-active government policies that aim at promoting particular sectors or industries are often not very effective. Programs are frequently undermined by fraud or hijacked by special interest groups, so that they provide a poor return on the financial and administrative resources that are allocated to them. In such situations, it is generally better for the government to devote its attention to addressing any existing impediments to general private sector developments, such as removing infrastructure bottlenecks, breaking up domestic monopolies, and strengthening contract enforcement. The resulting productivity improvements will make producers more competitive, both on the domestic and the international markets.

2.3 Services trade and foreign investment are becoming increasingly important

Despite having largely been ignored by government efforts to promote the non-oil sector, services trade has developed more dynamically over the past decade than non-oil merchandise. Services exports have clearly outpaced other non-oil exports and in 2004 were almost four times as important as non-oil merchandise exports (Figure 14). While Nigeria remains a net importer of services, the share in the total non-oil trade deficit due to services trade fell from a third in 1995 to 15 per cent in 2004.

Figure 14: Dynamics of non-oil trade
(per cent of GDP)



Source: World Bank staff based on data from the Central Bank of Nigeria.

This development is not entirely unusual or surprising. Services trade has become a driver of growth in many developing countries. The sectoral expansion has thereby gone beyond the traditional tourism trade (Box 3) and extended to a broad array of services sectors. Just as reductions in transport costs galvanized goods trade, reductions in communication costs and the digitization of services have turned call centers and other business services, for example, into the fastest growing segment of international trade. Considering that Nigeria is engaged in a substantial program of liberalization and opening of its core infrastructure services, including telecoms, services trade could play a significant role in the diversification and growth of the economy. Indeed, with the services sector currently representing merely 24 per cent of GDP (45 per cent of non-oil GDP) – compared with 60-65 per cent for major regional services hubs in Africa – the margin for sectoral growth is evident.

The liberalization of the telecommunications sector provides an example of a relatively successful services reform. In particular, the opening of the market fostered lively competition to the ultimate benefit of consumers. By 2004, Nigeria counted two national carriers, four mobile phone providers, 22 fixed line providers and 36 providers of Internet services. About 450 000 jobs have been created to serve the mobile phone industry, some of which in the informal sector, e.g. as vendors of pre-paid recharge cards. Similarly, the development of internet services has led to the opening of an estimated 5 000 cyber-cafés. Moreover, other forms of services trade have emerged at the margin of the telecoms reform. For example, Nigeria is due to open major call center facilities in 2006, based on initiatives by companies like *British Airways* and *Resourcery*.

The prices of telecommunications services have decreased significantly during the liberalization process. For example, the mobile call tariff dropped by more than 50 per cent following the arrival of a fourth operator on the market in 2003. Similarly, the Internet access time was cut by half over the past five years. While there is still significant room for improving the quality and reducing the cost of services, competition among providers should continue to lead to upgrades in services while putting pressure on prices. As a result, the cost of operating businesses in Nigeria will tend to decline, thereby contributing to an increased competitiveness of Nigerian firms.

Box 3: Tourism: a sector with export potential?

Tourism trade has played a key role in growth and diversification strategies of a number of developing countries. Nigeria, however, has so far not featured among the popular destination for tourists. A recent survey identified Nigeria's main weaknesses as a lack of security, widespread corruption of officials, political instability, and the absence of systematic tourism promotion. In comparison with other African destinations, Nigeria scored 'worse' or 'much worse' in the listed categories (Flannery, 2005).

Nevertheless, the Nigerian tourism industry has grown rapidly in recent years. In 2005, personal travel and tourism expanded by almost 15 per cent and business travel by more than 13 per cent. The occupancy rates of hotels in the country reached an exceptionally high 85 per cent (Federal Office of Statistics, 2005a). Growth thereby outpaced the expansion of the sector in other countries in sub-Saharan Africa by a significant margin. Overall, the travel and tourism sector generated value-added of about USD 1 billion, equivalent to 1.5 per cent of GDP, and was responsible for more than 400 000 jobs, representing 1.3 per cent of total employment. Moreover, tourism has important spill-over effects in other sectors of the economy. The World Travel and Tourism Council estimates that the sector directly and indirectly accounts for more than 2 million jobs and 7.7 per cent of GDP (WTTC, 2005).

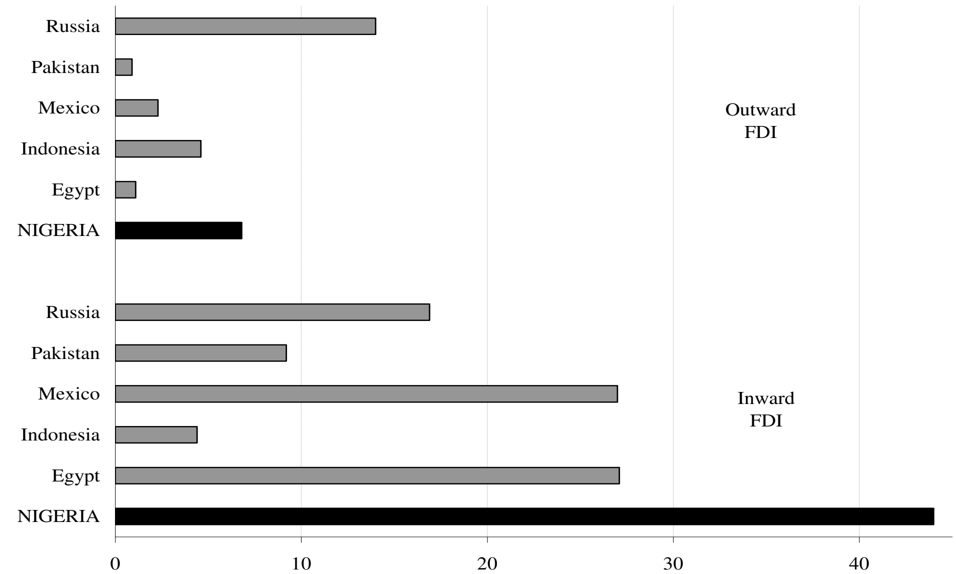
The question remains, however, whether the strong growth in the tourism sector is an early sign of a significant potential for tourism trade or just a mechanical catch-up after years of political instability and associated contraction. In comparison with other countries, trade in the sector remains largely underdeveloped in Nigeria. Moreover, most trips to Nigeria have so far either been motivated by business (60 per cent of air visitors) or by visits to friends and relatives (15 per cent). Only 5 per cent of all visitors came to Nigeria primarily for vacation. Given the natural and cultural tourist attractions that the country possesses, there might well be an untapped potential for increased regional and international tourism.

The government seems to be aware of the opportunities and has recently privatized several hotels in order to improve management. It has also renewed its efforts to design a strategy for developing the tourism sector. However, additional efforts are needed to harness the potential benefits from trade in the sector. Initiatives should aim first of all at improving the status and image of the country as a safe and pleasant destination for travel, but also cover the reversal of environmental decay, the protection and enhancement of natural and historical assets, and the strengthening of statistical data and market research.

Some of the telecommunication licenses have been granted to foreign companies and have represented a significant source of income for the government (about USD 1.1 billion during 2000-2003). The opening of the sector also generated important investments, including by foreign investors. For example, two private equity funds invested USD 43.2 million in *Starcomms* in 2004 – which was the largest FDI transaction in Africa during that year.

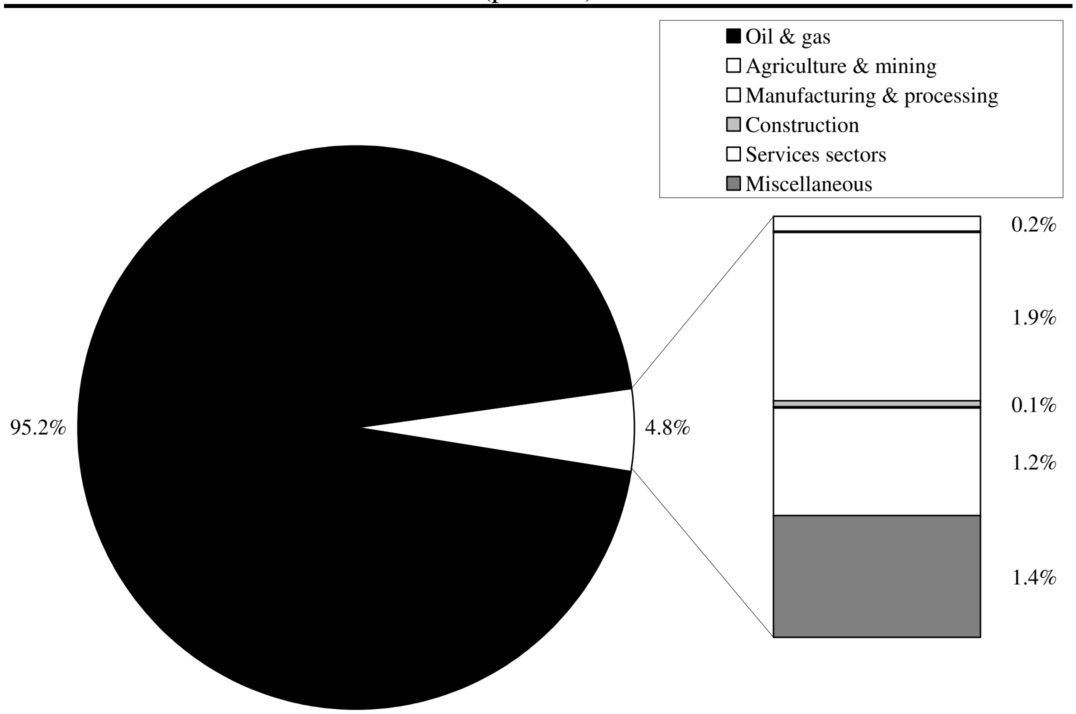
Nigeria is actively promoting inward FDI through the Nigerian Investment Promotion Commission and the incentive measures the latter administrates. These range from visa policies to tax incentives and investment guarantees. By 2004, the stock of inward FDI in Nigeria had grown to 44 per cent of GDP. This ratio is remarkably high and exceeds the FDI-to-GDP indicator in the five comparator countries by a substantial margin (Figure 15). However, FDI inflows remain highly concentrated on the oil and gas industry. During the five-year period from 2000-2004, more than 95 per cent of all inflows were going into the energy sector, while only a meager 1.9 per cent and 1.2 per cent, respectively, went into the manufacturing and services sectors (Figure 16). Yet, the share of services-FDI is bound to increase in the near future, as major services industries, such as port logistics, are being privatized (Figure 17). This opening of previously state-owned companies for private capital is providing a welcome opportunity for Nigeria to attract foreign investment and the managerial and technological know-how that comes along with it.

Figure 15: Stock of foreign direct investment, 2004
(per cent of GDP)



Note: Inward FDI refers to investments by foreigners in the particular country, while outward FDI are investments by residents abroad.
Source: UNCTAD (2005a).

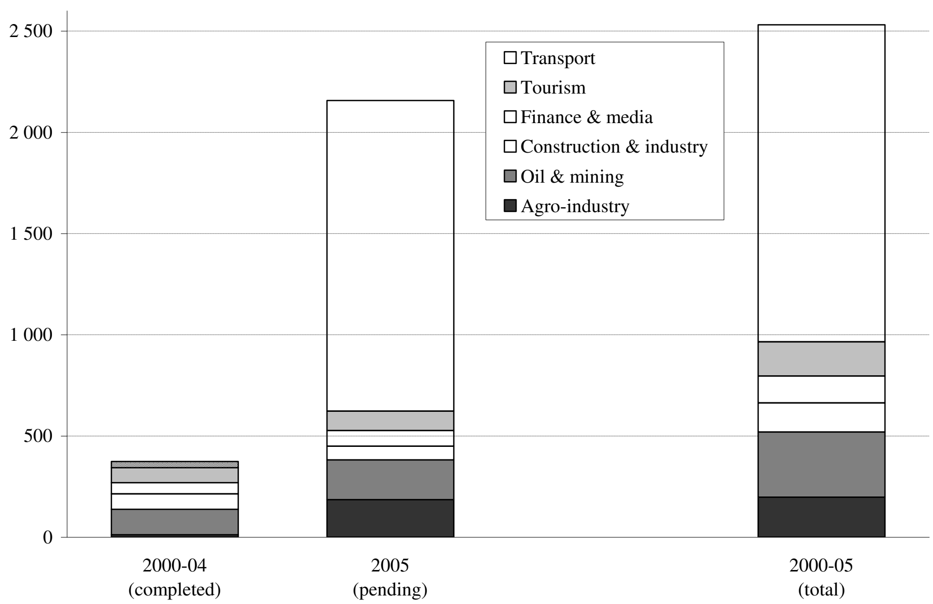
Figure 16: Structure of cumulative inflows of foreign direct investment, 2000-04
(per cent)



Source: UNCTAD.

Nigerian firms also hold non-negligble assets abroad, with the stock of outward FDI amounting to about 7 per cent of GDP. These investments are frequently related to companies, such as banks, hotel groups, or construction firms, providing a service abroad through a locally-established affiliate, subsidiary, or representative office. Some countries are collecting and reporting data on foreign affiliates trade abroad that capture not only capital flows linked to the establishment (FDI), but also operations of the affiliates, such as sales, employment or value-added. However, no such information is currently available for Nigeria.

Figure 17: Privatization receipts
(constant 2000-USD, millions)



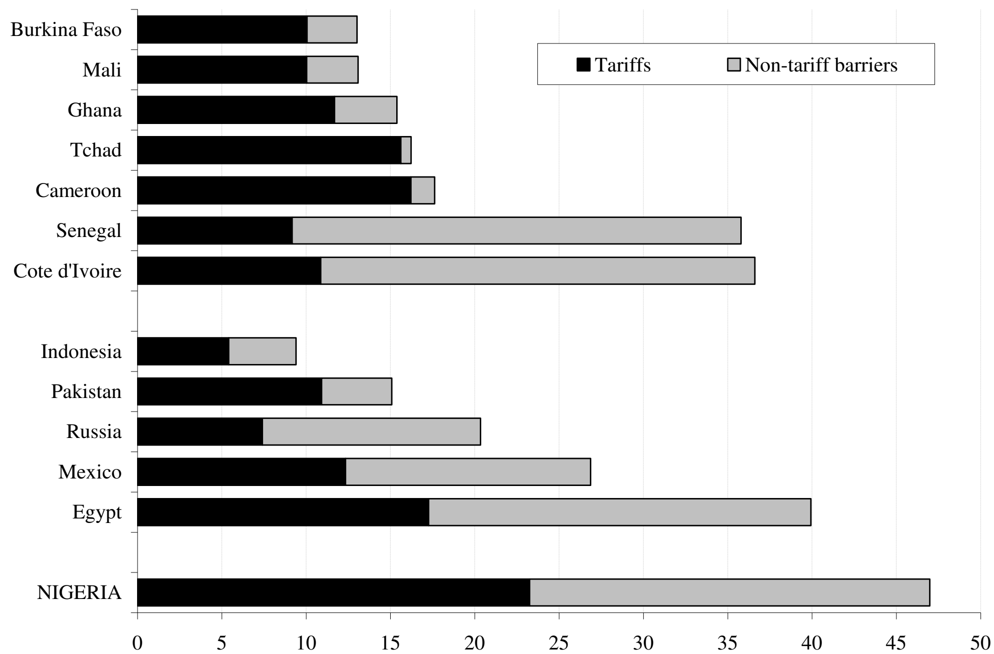
Note: The 2005 data includes projects that have been signed, but for which the transaction has not yet been completed.
Source: World Bank staff based on data from the Bureau of Public Enterprises.

3. HAS DOMESTIC MARKET PROTECTION GENERATED THE HOPED-FOR BENEFITS?

Nigeria has historically shielded domestic producers from international competition through high tariffs, import prohibitions, and other barriers. A team of analysts in the World Bank's Research Department has recently estimated a measure of import barriers that aggregates both tariff and non-tariff measures applied during the early 2000s (Kee, Nicita, and Olarreaga, 2005). This Overall Trade Restrictiveness Index (OTRI) corresponds to the uniform tariff that if imposed on all imports from partner countries would leave overall imports unchanged. The indicator takes unilateral, bilateral and regional market access preferences into account, and is derived through econometric estimation, based on a set of country-specific import demand elasticities (Kee, Nicita and Olarreaga, 2004).

Among the 91 countries for which data are available, Nigeria has the second highest OTRI (just after Sudan). The country's applied structure of tariff and non-tariff protection corresponds to a uniform import duty of 47 per cent, i.e. almost three times the world average. Tariff and non-tariff barriers contributed in about equal proportions to the domestic market protection. On a sectoral basis, the OTRI amounted to 75 per cent for agricultural and 21 per cent for manufacturing products. Nigeria's trade regime was thereby significantly more restrictive than that of most of its regional trade partners and international comparators (Figure 18).

Figure 18: Overall trade restrictiveness index
(per cent)



Note: Data for early 2000s, depending on availability. Other ECOWAS members not included due to lack of information.
Source: World Bank staff based on Kee, Nicita and Olarreaga, 2005.

The resulting lack of exposure to foreign competition and international trade practices has not helped to strengthen the competitiveness of domestic producers, as shown by the country's disappointing non-fuel trade performance. The GON has realized the shortcomings of past policies and has recently embarked on reforms of its trade incentive and border logistics policies. In 2002, GON approved a Trade Policy Document prepared by the Ministry of Commerce that contains an ambitious and comprehensive agenda for policy and institutional reform on trade policy. Moreover, the National Economic Empowerment and Development Strategy (NEEDS) of 2004 confirms the government's intention to lower or remove barriers to trade. Since then, GON has launched major initiatives to modernize Customs and port management, and adopted the ECOWAS common external tariff (CET) in October 2005.

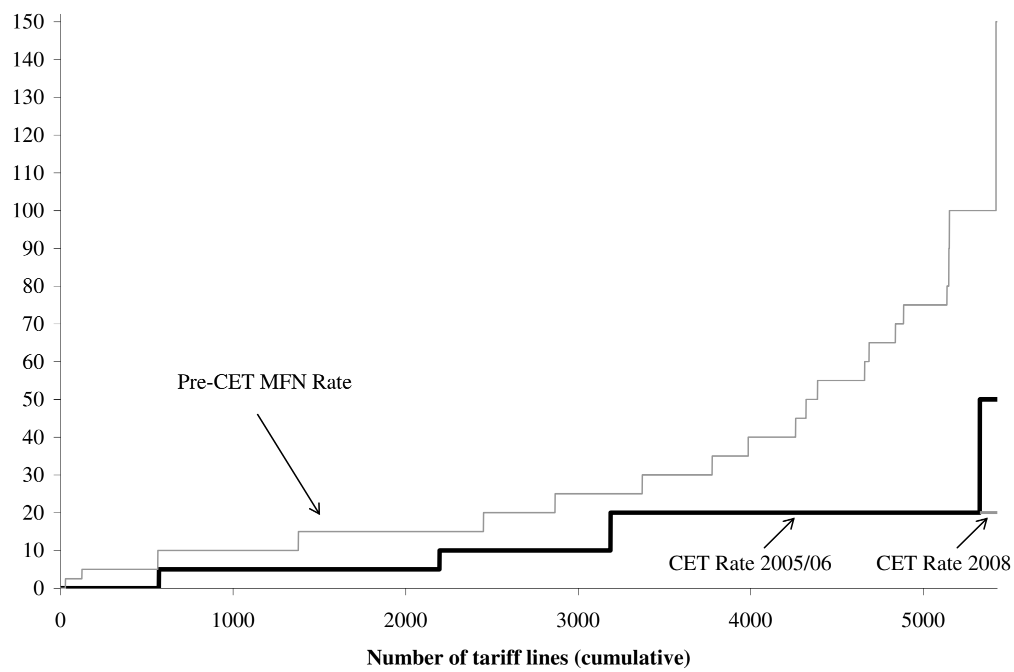
Trade reforms can be undertaken in different settings. They can notably be pursued through unilateral initiatives, plurilateral integration, or multilateral trade barrier phase-outs. An examination of tariff reductions since 1980 in the 33 largest developing country importers found that two-thirds of the changes in trade-weighted most favored nation (MFN) tariffs were due to autonomous liberalization, a quarter to reforms in the context of the WTO, and the remaining ten per cent to regional integration (World Bank, 2005b). Hence, domestic policy initiatives tend to be the main drivers for trade reform in many countries, and the commitment of Nigerian policy makers towards the implementation of their reform project will be crucial for its success.

3.1 Tariff protection has given rise to strong anti-export bias

The adoption of the CET in October 2005 implies a major change in Nigerian trade policy. Customs was not able to publish the tariff book until the end of November and the list of sensitive products that are subject to special 50 per cent import duties was not agreed upon until the end of 2005. But by the beginning of 2006, the CET was in place and GON has repeatedly stated its intention to remove current exemptions from the CET and any remaining import bans by the end of 2007. It is unclear, though, whether the phase-out of special duties on sensitive products and of import prohibitions will be undertaken in a single, or in several, more gradual steps.

The ECOWAS-CET consists of four bands (zero per cent, 5 per cent, 10 per cent, and 20 per cent), similar to those already being applied by members of the West African Economic and Monetary Union, which is composed of a sub-set of ECOWAS member countries. During the transition period until the end of 2007, Nigeria applies 50 per cent duty rates to imports in 102 tariff lines, or 1.9 per cent of all lines. The resulting tariff profile is significantly less dispersed and carries lower average duty rates than Nigeria's pre-CET schedule (Figure 19). Indeed, after having reached almost 30 per cent in the recent past, the adoption of the CET is bringing simple average import duties down to 12.1 per cent (11.6 per cent once the CET is fully implemented in 2008). The liberalization is particularly marked for agricultural products, which used to receive very high protection, but similarly felt in manufacturing (Table 4). Yet, in addition to the MFN-duties, Nigeria continues to apply several levies to imports, including a port development levy (7 per cent of duty payable), a comprehensive import supervision scheme charge (1 per cent of customs value), the ECOWAS community levy (0.5 per cent of customs value), as well as product-specific levies and excise duties (Nielsen, 2005; WTO, 2005). Also, many imports are subject to non-tariff barriers, notably import prohibitions, which adds significantly to the restrictiveness of the import regime (see separate section below).

Figure 19: Tariff profile in Nigeria
(rates in per cent)



Source: World Bank staff based on data from Nigeria Customs Service.

Table 4: MFN tariffs in Nigeria

	1997/98	1999/00	2001	2002	2003	CET 2005/06	CET 2008
Simple average tariff rate	24.4	26.0	26.0	29.0	28.6	12.1	11.6
Agriculture (ISIC, Div. 1)	26.7	26.3	26.7	41.5	41.4	12.8	12.6
Mining and quarrying (ISIC, Div. 2)	18.3	18.4	18.4	18.4	17.9	5.2	5.2
Manufacturing (ISIC, Div. 3)	24.4	26.1	26.2	28.5	28.0	12.2	11.6
Domestic tariff spikes (% of lines)	0.5	0.5	0.5	5.2	5.0	1.9	0.0
International tariff spikes (% of lines)	51.6	57.9	57.9	57.4	56.5	41.3	41.3
Overall standard deviation	18.0	14.6	14.5	22.0	22.3	9.1	7.5

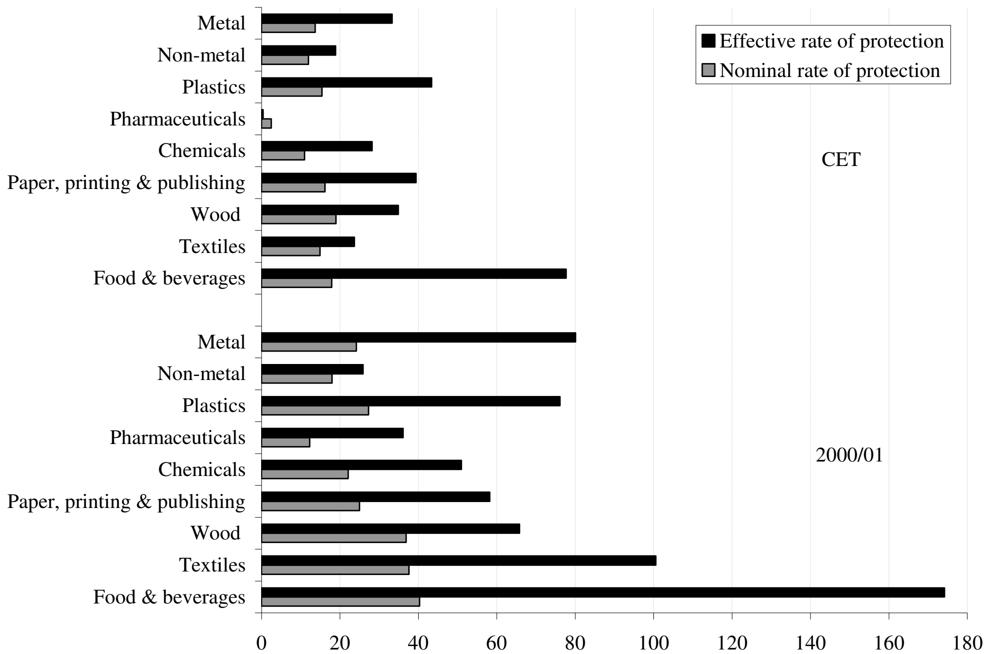
Note: Domestic tariff spikes are defined as tariffs exceeding three times the overall simple average applied rate. International tariff peaks are defined as tariffs exceeding 15 per cent.
Source: World Bank staff based on data from Nigeria Customs Service, and WTO (2005).

Domestic market protection comes at a cost, notably to consumers and firms, including service providers, that source their inputs domestically. Also, tariff protection introduces an anti-export bias. If firms produce for the export market, they do not receive the same market price support that producers for the domestic market enjoy. Since Nigeria can not influence world market prices, exporters do not receive the significant policy-generated transfers that producers for the domestic market obtain, thus biasing producers' decisions against selling abroad. Indeed, the higher the domestic market protection is, the stronger the anti-export bias becomes. Hence, by adopting the CET with its lower tariff protection, Nigeria will induce producers to no longer focus their marketing attention primarily and largely on the domestic market, but pursue additional efforts to explore opportunities abroad.

Nigeria's old and new tariff structures are in general escalatory, such that import duties on raw materials are lower than those on semi-processed products, which in turn are lower than the tariffs on finished goods. Producers have access to inputs at low-tariff rates, while being able to shield behind high import barriers for their final products. The effects of such tariff escalation on the protection of value-added of an activity can be measured through effective rates of protection (ERPs). The latter provide a better representation of tariff-generated transfers to producers than nominal rates of protection, as they take protection on both inputs and outputs into account.

For Nigeria, a team of analysts has estimated the change in ERPs following the application of the CET based on a sample of 77 firms in different manufacturing sectors (Rajhi and Marchat, 2004). They find that ERPs will fall in line with the reduced nominal protection, but remain considerable in some sectors, such as food processing and plastics, with rates still exceeding 40 per cent (Figure 20). On the other hand, textiles producers will experience large reductions in effective protection, and ERPs for pharmaceuticals are projected to fall below nominal protection rates.

Figure 20: Nominal and effective rates of protection
(per cent)

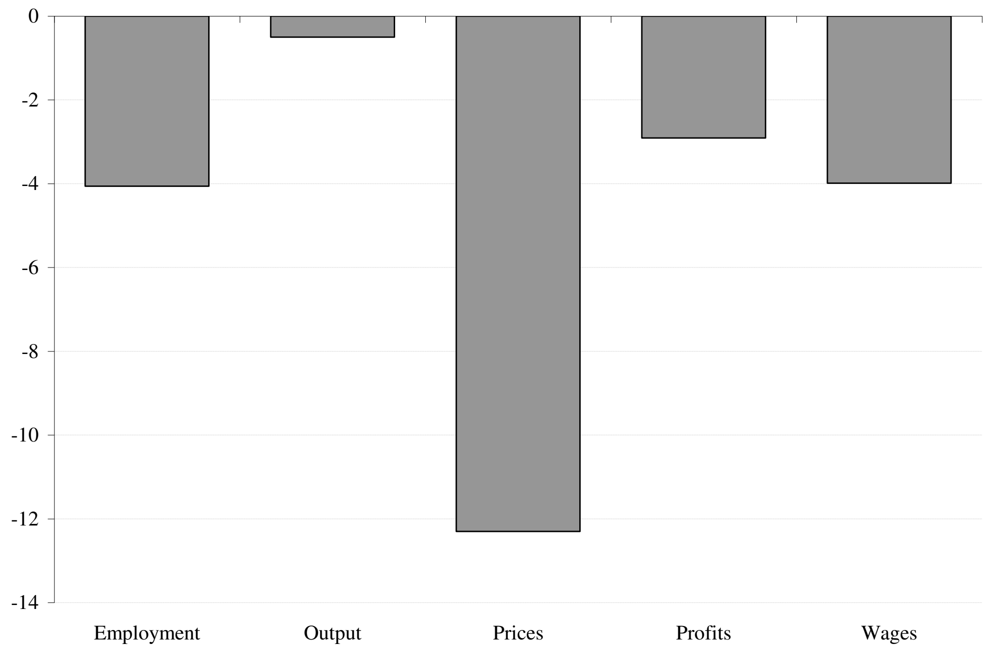


Source: Rajhi and Marchat (2004).

How will producers be able to cope with the reduced protection and the more competitive environment? Lower output tariffs can generate productivity gains by inducing tougher import competition, whereas cheaper imported inputs can raise productivity *via* learning, variety, or quality effects. A recent study investigated Indonesia's experience of tariff reform during the period 1991-2001 and found that a 10 percentage point fall in output tariffs increased productivity by about 1 per cent, whereas an equivalent fall in input tariffs led to a 3 per cent productivity gain for all firms and an 11 per cent productivity gain for importing firms (Amiti and Konings, 2005). Earlier, Revenga (1997) found that large scale tariff reforms in Mexico during the 1980s with the reduction of maximum tariffs rates from 100 to 20 per cent led to only modest declines in employment levels of 2 to 3 per cent.

Available estimates on the short-term impact of CET-adoption for Nigerian producers similarly suggest that the direct costs associated with the change in the trade regime will be small. Econometric simulations put the prospective reductions in employment levels, wages and profits of manufacturing firms within a 3 to 4 per cent range each (Figure 21). The small overall impact on the labor market is thereby explained by the analysts as a result of the stickiness of employment relations.

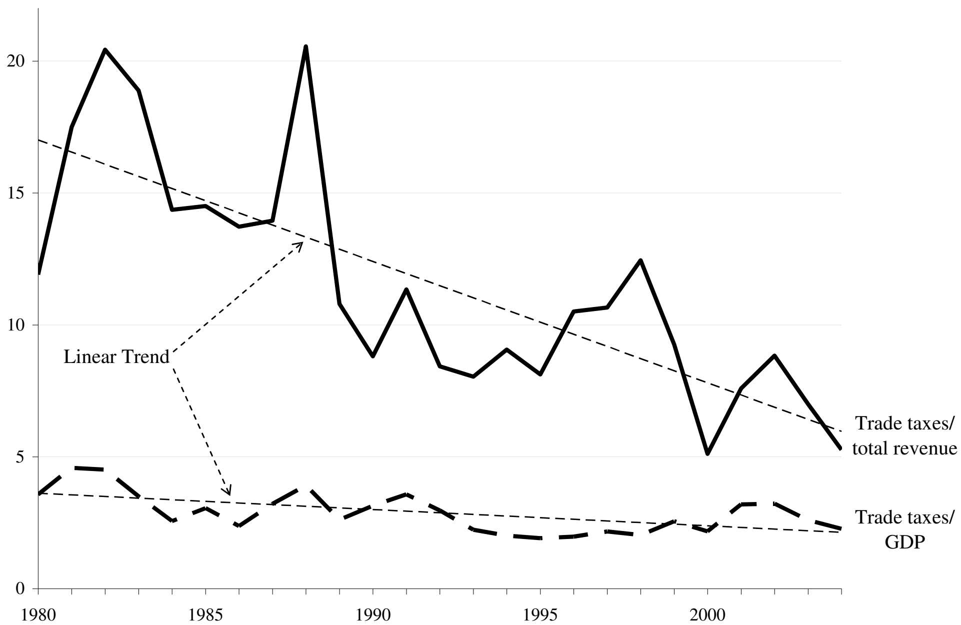
Figure 21: Prospective impacts of CET adoption on manufacturing
(per cent)



Source: Rajhi and Marchat (2004).

The lower duty rates of the CET will also affect tariff revenues. There are two countervailing effects. On the one hand, lower duties will translate into lower revenues on existing imports. On the other hand, the reduced tariff might foster additional imports or might lead to informal trade shifting to official channels, so that the import volume and with it tariff revenue increases. Which of the two effects eventually prevails is difficult to say. In any case, Nigeria is in a fortunate position, since only a small and decreasing portion of its total governmental revenues is derived from trade taxes (Figure 22). The share of trade-related governmental revenue fell from more than 20 per cent in the early 1980s to little more than 5 per cent in 2004. Hence, potential shortfalls in tariff revenues should be relatively easy to accommodate given the relatively broad revenue base.

Figure 22: Relative importance of trade taxes
(per cent)



Note: Trade taxes include import duties, excise duties and fees that go directly to the Federation account, but not earmarked import levies, such as the port development surcharge, the Nigerian Shippers Council surcharge and the Raw Material Research and Development Council surcharge.
Source: World Bank staff based on data from Central Bank of Nigeria (2004).

3.2 Import prohibitions and poor trade logistics remain major impediments

Nigeria has been making extensive use of non-tariff barriers, notably import bans, to shelter domestic producers from foreign competition. The practice of prohibiting imports of selected products was widespread in the 1980s and early 1990s, and after GON replaced a number of prohibitions through high tariffs since the late 1990s, major expansions in the list of prohibited imports occurred again in 2001, 2003 and 2004. In November 2005, 944 tariff lines (down from 1130 lines in January 2004) were subject to import bans. In other words, nearly a fifth of all products in the tariff schedule can not be legally imported into Nigeria. In addition, there were partial bans in 76 tariff lines, which mostly relate to imports of consumer durables in used form or prescribe minimum import quantities or specific import locations. It has been estimated that banned products might in the absence of the prohibitions account for 5-10 per cent of total imports (Ruffer, 2004).

The incidence of import bans is highest in the textiles, apparel and leather sector, where more than 70 per cent of all tariff lines are subject to import prohibitions (Table 5). Import bans are also prevalent in agriculture and wood & furniture production, with about a quarter of all tariff lines affected. The import duties that the banned products would face in the absence of the prohibitions are in general higher than the average for the sector, so that a lifting of the bans would still leave domestic producers with considerable protection.

Table 5: Import bans and tariffs by sector, November 2005
(per cent)

Sector (ISIC Rev. 2)	Share of tariff lines with import ban	Simple tariff average in sector	Simple tariff average, banned items	Simple tariff average in sector	Simple tariff average, banned items
		CET-2005/06		CET-2008	
Agriculture	23.3	13.5	18.8	13.3	18.8
Forestry	0.0	5.0		5.0	
Fishing	0.0	13.5		13.5	
Coal Mining	0.0	5.0		5.0	
Crude Petroleum & Natural Gas	0.0	5.0		5.0	
Metal Ore Mining	0.0	5.0		5.0	
Other Mining	1.4	5.3	5.0	5.3	5.0
Food, Beverages & Tobacco	17.3	17.8	22.4	16.0	18.1
Textiles, Apparel & Leather	71.6	17.1	18.0	17.1	18.0
Wood & Furniture	29.6	19.0	19.6	19.0	19.6
Paper, Printing & Publishing	11.5	11.5	18.9	11.5	18.9
Chemicals, Rubber & Plastic	3.9	8.2	13.5	8.0	13.5
Non-Metallic Minerals	1.9	16.2	13.3	16.2	13.3
Basic Metals	0.0	12.6		9.5	
Fabricated Metals & Machinery	1.4	8.9	14.5	8.4	14.5
Other Manufacturing	5.6	17.4	20.0	17.4	20.0

Source: World Bank staff based on data from Nigeria Customs Service and Ministry of Finance.

Nigeria's lackluster economic and export performance suggests that years and decades of import prohibitions (and other import restrictions) have generally not helped to improve the competitiveness of its domestic producers. Similar to other trade restrictions, import prohibitions distort the allocation of resources in favor of uncompetitive domestic industries and often to the detriment of more efficient producers. Also, they tend to raise consumer prices in the domestic market, thereby undermining the Government's efforts to reduce poverty (Box 4). Moreover, the bans have proven to be difficult to enforce as they provide incentives for smuggling, so that many banned imports are readily available for purchase in the country. The losses in tariff revenues due to unofficial imports of banned products have been estimated to amount to 8-10 per cent of total tariff revenue (Ruffer, 2004).

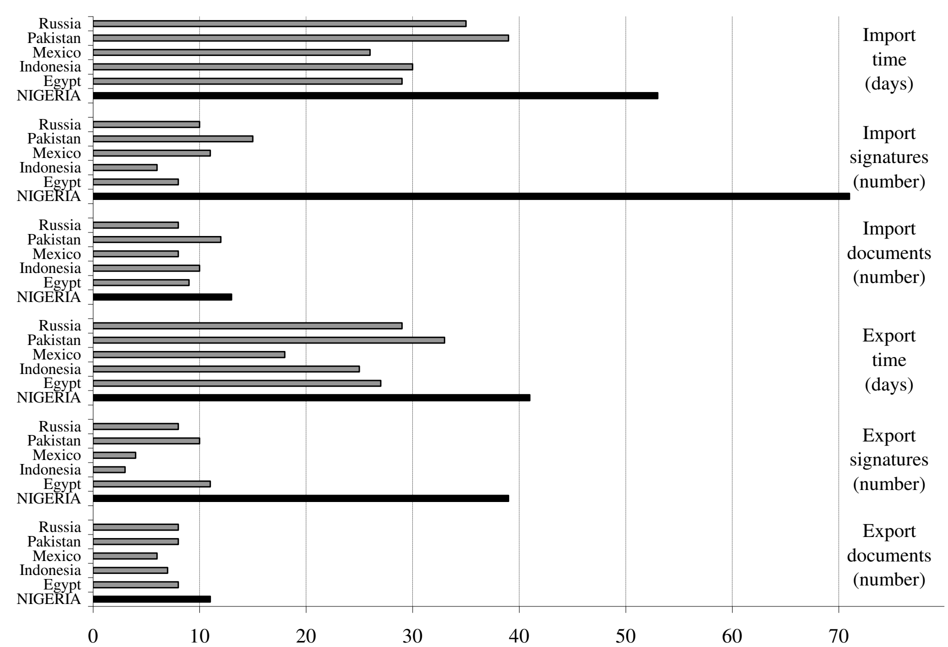
As part of the undertaking to align Nigeria's trade regime with that of ECOWAS, import prohibitions that are not implemented for security, health, or morality grounds are supposed to be phased out and replaced by CET-duties. However, the government is continuing to modify and augment the import prohibition list through notices and decrees. Also, exemptions from import bans on an *ad hoc* basis are continuing to provide opportunities for rent seeking activities of politically well-connected businessmen and corrupt customs officials.

The frequent and often intransparent regime changes of import bans increase policy uncertainty, undermine the credibility of Nigeria's commitment to regional and global integration, and are a constant source of friction with the country's neighbors. Developing and adhering to a clearly outlined schedule of import prohibition removal would therefore be a boon to the predictability of Nigeria's trade policy and its relations with trading partners. In cases where bans are motivated by alleged dumping practices, safeguard mechanisms that are in conformity with international trade law would be clearly superior to *ad hoc* prohibitions.

Nigeria also implements export bans for several products with the aim of fostering the domestic downstream sectors (bans on exports of hides, timber, scrap metals and rubber) or to promote the availability of sufficient food on the domestic market (export bans on maize and rice). Such export restrictions do most often fail to achieve their intended objectives (Piermartini, 2004). Similar to import restrictions, export bans and taxes encourage inefficient production and consumption patterns and a suboptimal resource allocation. Moreover, there are frequently adverse distributional impacts. If the export restrictions concern primary commodities, as in Nigeria, it is often poor smallholders, who have to bear the bulk of the economic costs, as prices for their produce are being depressed.

In addition to the often unpredictable, yet official barriers to imports in the form of tariffs and import prohibitions, there are substantial informal trade barriers in Nigeria's logistics sector that add further distortions to the import regime. Importers face long clearance procedures, high berthing and unloading costs, erratic application of customs regulations, and corruption. A recent World Bank project collected information on the number of necessary documents and signatures as well as the time required to undertake import or export transactions. Nigeria scores worse than its comparators in all dimensions (Figure 23). It takes more than a week longer in Nigeria to complete all export procedures than in the worst of the comparator countries, and on the import side, the difference even amounts to two weeks. And, the comparators are far from representing international best practice.

Figure 23: Indicators of border process efficiency

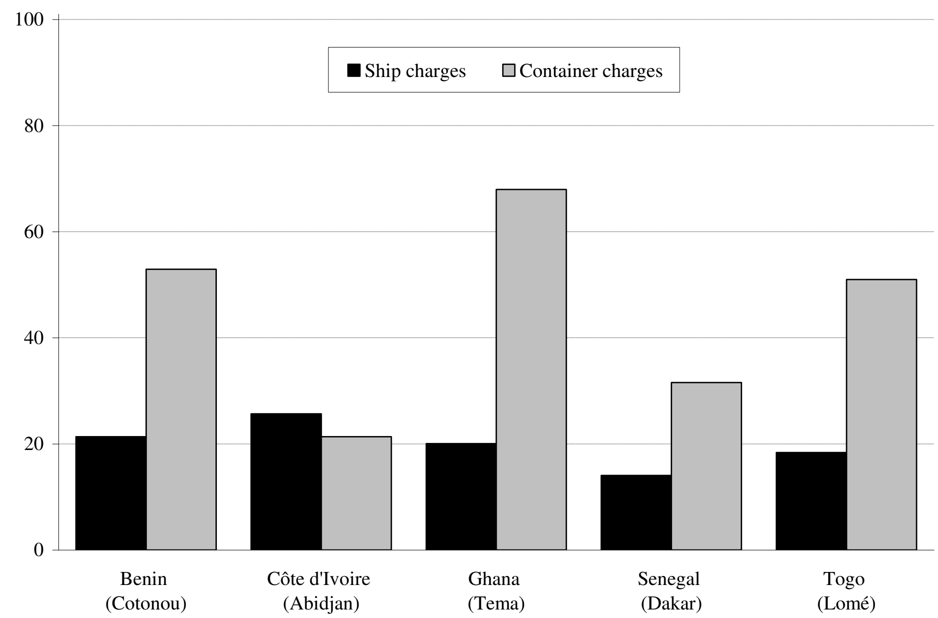


Source: World Bank (2006b).

The difference in border process efficiency is most striking with respect to the number of signatures required to clear imports. In Nigeria, the importer has to collect more than 70 signatures, while most comparators require only ten or less. This multitude of official approvals adds considerable bureaucracy to the importing process and slows it down. It also provides ample opportunity for customs officials to ask for unofficial fees to expedite the clearance of goods. Indeed, a recent survey reported that among the 32 public organizations considered, only the Nigerian Police and the National Electric Power Authority were found to be more corrupt than the country's Customs and Excise Department (Independent Advocacy Project, 2005). GON intends to undertake a comprehensive reform and strengthening of the customs service, but progress has been slow to date due to resistance to the envisaged changes from within the administrations concerned.[2]

The poor performance of Nigeria's ports is another major impediment to better international trade integration. Port charges are a multiple of those in other West African ports (Figure 24). But reforms are more advanced in this area, and the Bureau of Public Enterprises estimates that the ongoing port privatization will reduce trade transactions costs by 5-13 per cent of customs value (Table 6).

Figure 24: Port charges in Western Africa
(Nigeria = 100)



Note: Ship charges refer to a 1500-1800 TEU container chip; container charges represent a weighted average that assumes 70 per cent 20ft and 30 per cent 40ft containers.
Source: Royal Haskoning (2002).

[2] See the section on trade facilitation in the business climate chapter for details on the customs and port reform process.

Table 6: Estimated savings arising from port privatization
(per cent of cargo value)

	Port charges	Additional levies	Informal charges	Sea freight	Inventory costs	Truck waiting	Total savings
Container cargo							
containers	0.2	4.0	0.1	0.2	0.5	0.1	5.1
General cargo							
bagged rice	2.0	4.0	1.2	4.2	0.5	0.8	12.7
steel	0.4	4.0	0.2	0.9	0.5	0.2	6.2
frozen fish	1.6	4.0	1.0	3.4	0.5	0.7	11.2
Bulk cargo							
wheat	0.4	4.0	0.3	0.7	0.1	0.3	5.8
cement	1.3	4.0	0.8	1.9	0.1	0.8	8.9
fertilizer	0.5	4.0	0.3	0.8	0.1	0.3	6.0
sugar	0.7	4.0	0.4	1.1	0.1	0.4	6.7
salt	1.4	4.0	0.9	2.2	0.1	0.9	9.5

Notes: (a) port charges: assumed reduction by 25 per cent.
(b) additional levies: mainly a reduction in the Port Development Surcharge and NMA charge;
(c) informal charges: nominal (but probably conservative) allowance for ghosting and corruption;
(d) sea freight: assumes that approximately 50 per cent of ships' time savings for general cargo and bulks are passed on, resulting in savings to the consumer of US$4 .00 and US$ 2.00 per ton, respectively. The impact on container freight rates is likely to be small;
(e) inventory costs: assume a seven day reduction in transit time for general cargo, and a two day time saving for bulk cargo. Figures for containers are based on Year-1 savings (seven days) and should increase from 0.5 per cent to 1.2 per cent of cargo value by Year-10, when the streamlining of Customs procedures is complete;
(f) truck waiting: time savings are estimated at US$ 0.8 per ton for general cargo and bulks, and US$ 25 per TEU.

Source: Bureau of Public Enterprises, 2005a.

3.3 Privatization and services reforms have been getting under way

While goods sector remain protected in Nigeria, the government has adopted a more liberal stand with respect to services. Since 1999, GON has engaged in a broad program of reforms in the services sector with the privatization of public enterprises and the revision of key legal and regulatory frameworks. The objective has been to foster competition and to make services more efficient. Between 1999 and 2004, the government privatized more than 30 companies, and in 2005, another 42 transactions were concluded. About 30 public enterprises, including companies in the oil, gas and mining sectors as well as in transport (airport authority, railways and waterways) and postal services, remain to be privatized, but the Bureau of Public Enterprises is confident that this process will be expeditious (BPE, 2005b).

Privatization does not necessarily imply liberalization and opening to international competition, as foreign investors can potentially be excluded from the sale and state monopolies can inadvertently be turned into private ones. In the case of Nigeria, however, the privatization initiative launched in 1999 was generally accompanied by the reinforcement of competition (liberalization) and the promotion of foreign investments (opening). The transactions included core investor sales, concessions, liquidations and public offers, with frequent participation of foreign investors. The exact amount of FDI embodied in these privatizations is difficult to estimate, though, since most transactions were concluded by consortia of Nigerian and foreign companies.

While not all the privatizations and reforms engaged are implemented yet, there is significant potential that the liberalization process could generate substantial dynamic gains. The reforms will not only eliminate the financial drain that the public enterprises have represented for the state treasury in the past (Table 7), but also tend to improve management and make the respective companies more competitive, thereby creating new trade opportunities in the liberalized sectors themselves and in other sectors relying on their efficiency. In particular, the reduction of the cost and the increased efficiency of core infrastructure services would have a significant impact on the performance in most other sectors. Some observers estimate that the concessioning of ports could add 5 per cent to the economy's GDP over the next ten years, the concessioning of railways another 2 per cent, and growth in the telecommunications sector a further 1-3 per cent.

Table 7: Net fiscal balance of public enterprises

(NGN billion)

	2000	2001	2002	2003	2004
Nigeria Gas Company	-72.6	-43.6	-58.6	-55.1	-44.3
Nigeria Insurance Corporation	..	0.7	0.9	0.9	-2.0
Nigeria Ports Authority	-31.3	-16.7	-6.6	-19.7	..
Nigeria Railway Corporation	..	-36.0	-12.7	-25.0	-31.7

Note: Net fiscal cost includes net direct financial flows and foregone revenues.
Source: Economic Policy Positioning (2005).

Yet, every liberalization process has to be accompanied by appropriate legal and regulatory measures in order to reap the full benefits of reform. Despite efforts to improve the country's investment climate, disincentives to investing in Nigeria continue to plague foreign entrepreneurs. Potential investors must contend with poor infrastructure, complex tax administration procedures, confusing land ownership laws, arbitrary application of regulations, corruption, and extensive crime. The sanctity of contracts is often violated, and Nigeria's court system for settling commercial disputes is weak and sometimes biased (USTR, 2005).

Moreover, in the same way the benefits from reforms in the services sector can spill over into other sectors of the economy, protectionist measures in the manufacturing sector can hurt the development of services. For example, the ban on imports of mobile phone recharge cards since January 2005 has slowed the process of reducing prices through international competition and the arbitrariness of the application of such import prohibitions scares potential investors away. Similarly, the ban on imports of fully assembled radio, television, computer and other electronic products from June 2006 could have seriously damaging effects on the communications sector by slowing down the adoption of new technologies and impeding attempts to develop call centers or outsourcing services in Nigeria. Moreover, international experience suggests that artificially implanted assembly operations that are not integrated into established production chains and are, hence, unable to obtain the components at low costs on a just-in-time delivery basis are not viable without continued public subsidies. There is also very limited, if any, technology transfer associated with simple assembly operations.

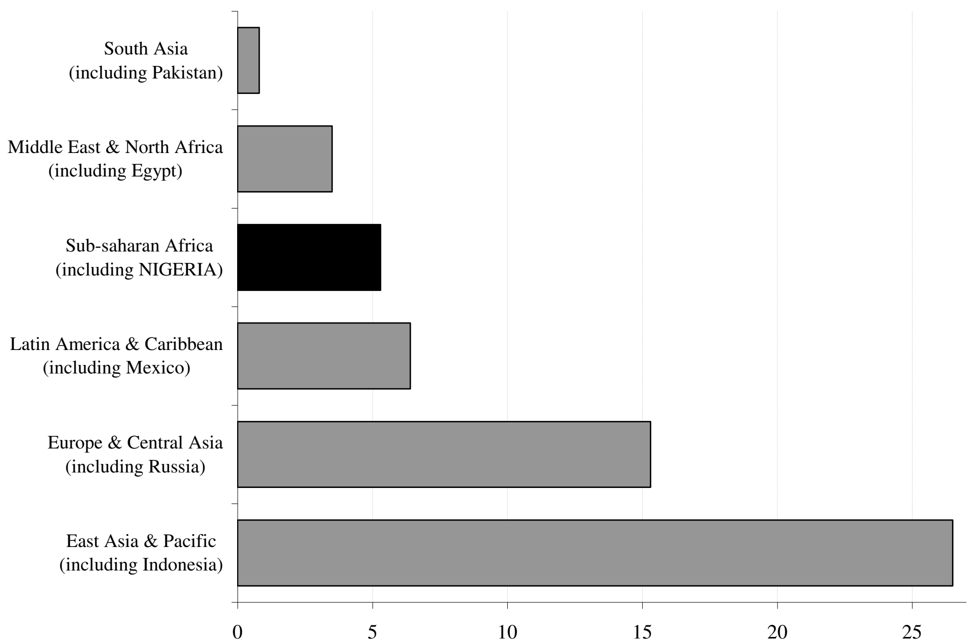
4. IS FURTHER REGIONAL INTEGRATION IN NIGERIA'S INTEREST?

Due to its size and rich natural resource endowment, Nigeria is the pivotal economic player in West Africa. The country is a member of the Economic Community of West African States (ECOWAS) and has renewed its commitment to regional integration with the adoption of the Common External Tariff in October 2005. Further regional integration is also a prerequisite for a successful conclusion of the Economic Partnership Agreement (EPA) with the EU, in which Nigeria participates as a member of the West Africa Group.

4.1 Regional trade is underestimated in official statistics

Regional production and trade networks are not very well developed in sub-saharan Africa, so that intra-regional trade accounts for merely 5 per cent of GDP. This share is higher than in South Asia and the Middle East/North Africa region, but only a third or a fifth as high as in Europe/Central Asia or East Asia (Figure 25). And Nigeria is no exception within sub-saharan Africa. According to official statistics, the country trades relatively little with partners in the region. In 2004, the share of exports that went to its neighbors or West Africa Group partners amounted to just 5.6 per cent of total shipments and its imports from countries in the region to merely 2.4 per cent. The country has a substantial trade surplus with regional partners, as its exports of almost USD 2 billion amount to more than five times its imports (Table 8).

Figure 25: Intra-regional trade as a share of GDP
(per cent)



Source: World Bank (2005b).

However, regional trade is substantially underestimated due to informal cross-border links. These transactions are particularly important with the four countries with which Nigeria shares land borders, i.e. Benin, Chad, Niger, and Cameroon. With these countries strong traditional trade routes exist, and the natural conditions permit transactions outside official channels. While by its nature no exact valuation of unofficial cross-border flows is available, the general consensus is that informal activities account for a significant share of total trade within the region (Page and Bilal, 2001). Some observers even estimate that 50 to 60 per cent of cross-border transactions between Niger and Nigeria are informal, and that 75 to 80 per cent of Benin's exports go to Nigeria *via* unofficial channels (Soulé, 2001; Meagher, 2003).

Table 8: Nigeria's officially recorded trade with partners in the region, 2004
('000 USD)

	Exports	Imports	Net-exports
Benin	22 109	14 919	7 190
Burkina Faso	145	1 844	- 1 699
Cameroon	223 970	21 637	202 333
Cape Verde	24	38	- 14
Chad	9 832	527	9 305
Cote d'Ivoire	671 550	213 590	457 960
Gambia, The	0	2	- 2
Ghana	661 450	26 465	634 985
Guinea	4 013	46	3 967
Guinea-Bissau	0	15 253	- 15 253
Liberia	0	916	- 916
Mali	4 958	614	4 344
Mauritania	517	14 681	- 14 164
Niger	45 735	49 899	- 4 164
Senegal	338 430	4 416	334 014
Sierra Leone	0	522	- 522
Togo	7 875	7 693	182
ECOWAS members	1 756 288	336 215	1 420 073
West Africa Group	1 756 805	350 896	1 405 909
West Africa Group plus neighbors	1 990 607	373 060	1 617 547

Note: West Africa Group is ECOWAS plus Mauritania; neighbors refers to Cameroon and Chad.
Source: IMF Direction of Trade database.

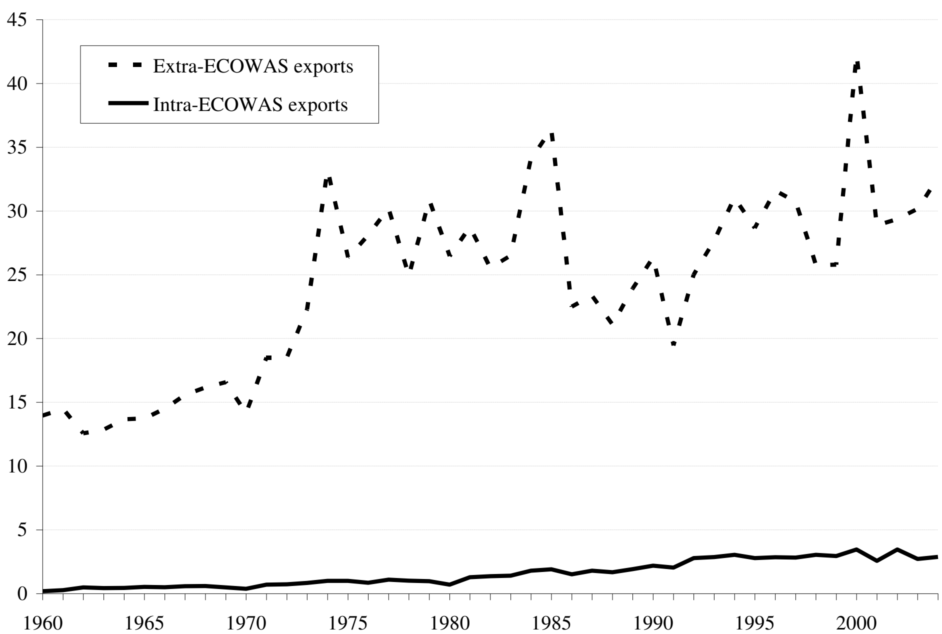
Informal trade flourishes despite disadvantages related to the small-scale of operations, high transport costs, and the risk of detection and punishment, whenever formal trade transactions costs are substantial due to high tariffs or inefficient border procedures. Such impediments give rise to price disparities across borders that provide an incentive to engage in arbitrage through informal trade. In some countries, such as Benin and Niger, informal trade has achieved a quasi-legal status in the re-exporting of merchandise, especially for products that are heavily taxed or subject to import restrictions in Nigeria (Soulé, 2001). Also, informal trade within Nigeria has to some extent become institutionalized, with strong links between formal and informal activities emerging since the early 1980s (Arimah, 2001). Formal sector firms act thereby as suppliers of raw material, equipment and machinery for informal traders, as well as providers of finance and consumer goods.

Deeper regional integration will not eliminate informal trade entirely, but shift the balance in favor of formal transactions. In particular, the harmonization of trade policies and regulations between Nigeria and its neighbors and the phasing out of intra-regional trade barriers will lower formal trade transactions costs and reduce the incentives to use unofficial channels. Also, the adoption and implementation of a common external tariff will eliminate the gains that can currently be obtained from world market imports into low protection countries, such as Benin, and subsequent informal transshipment into high protection countries, such as Nigeria. The ECOWAS Secretariat is embarking on a border survey-based activity that aims at improving the understanding of the extent and structure of informal trade. Since unofficial trade is of such central importance to Nigeria, the findings could help decision makers improve the policy process and support for this project seems, hence, in the country's best interest.

4.2 Integration with ECOWAS provides a welcome policy anchor

Nigeria is one of the 15 members of the Economic Community of West African States. Mauritania also used to be a member, but withdrew from the organization in 2002. Since the foundation of ECOWAS in 1975, trade between members has grown from about 1 per cent of GDP to nearly 3 per cent by 2004. But still, intra-ECOWAS trade accounted for only 8 per cent of total exports (Figure 26). In practice, regional trade is somewhat more important, though, as informal cross-border transactions are not covered in the official statistics.

Figure 26: Ratio of ECOWAS exports to GDP
(per cent)



Source: IMF Direction of Trade database.

One of the central objectives of ECOWAS has been to foster trade between its members and reap economic benefits from regional integration (Box 4). In particular, the ECOWAS Treaty calls for increased cooperation and integration within the West African subregion through the removal of customs duties, establishment of a common external tariff, the harmonization of economic and financial policies, and creation of a single monetary zone. In 1993, the ECOWAS treaty was revised to accelerate the process of integration. Progress towards more liberal and regionally harmonized trade systems has been slow, however. One reason for the limited integration pace is the fact that ECOWAS brings together countries with different cultural backgrounds. This does not only manifest itself in the area of communication between anglophone, francophone and lusophone (Guinea-Bissau) countries, but also in the different legal and regulatory traditions that the language groups represent.

The limited liberalization progress in services sectors provides an example of the impediments to the establishment of pan-regional policy regimes. Several chapters in the ECOWAS Treaty touch on services, and even though none of them explicitly requires the removal of identified barriers to services trade, member states undertake to develop common policies, laws and regulations. Also, the chapter on immigration gives ECOWAS citizen the right of entry, residence and establishment in other countries within the region, thereby facilitating trade and cross-border business transactions.

The integration of regional rules is particularly important for improving infrastructure services, whose efficiency depends on the scale of operation. A number of respective regional initiatives have been launched in the telecommunications, energy, and transport sectors. For example, guidelines have been adopted on the harmonization of telecommunications policies, and several new projects aim to improve the cross-border infrastructure and connectivity. Similarly, the West African Power Pool agreement plans to harmonize electricity transmission, generation and regulation in order to address the problems of recurring energy shortages that many of the ECOWAS countries, including Nigeria, experience on a regular basis. Regarding transport, a regional road transport and transit facilitation program and the application of the Yamoussoukro declaration on the liberalization of air transport are envisaged.

Box 4: Welfare impacts of regional integration initiatives

The overall welfare consequence of regional integration depend on several factors. If the reduction of intra-regional trade barriers fosters partner countries to expand output and exports of products for which they are internationally competitive, the price of final goods or production inputs on the importing country market falls to the benefit of consumers and input-purchasing producers. In this case, welfare-enhancing *trade creation* occurs.

Moreover, regional trade initiatives can have beneficial indirect effects. Opening domestic markets to partner countries, for example, can increase competition in sectors with previously highly concentrated industrial structures and thereby reduce the monopolistic pricing power of incumbents. Such pro-competitive impacts are particularly important for countries that have only a nascent domestic competition policy. Also, regional cooperation can be effective in harmonizing customs procedures and domestic regulations. Adopting common rules on investment, for example, has the potential to encourage increased inflows of foreign direct investment (FDI) by enhancing the credibility of FDI-policies and providing a restraint on sudden policy reversals.

Some observers justify RTAs in political economy terms by seeing them as laboratories for international integration, training grounds for negotiations at a broader level, and strategic means of trade policy making. By teaming up with regional partners, countries may be able to increase the weight of their positions in international trade negotiations and possibly achieve more favorable negotiation outcomes. Also, regional trade agreements make it possible for countries to gain some control over the trade policy of their partner countries.

Conversely, engaging in RTAs implies passing parts of a country's sovereignty on to the regional bloc. Hence, the institutional framework for trade policy making changes. Furthermore, RTAs may result in losses of government revenues, as tariffs on intra-regional trade are phased out, or promote costly *trade diversion* rather than welfare-enhancing trade creation, if trade is shifted from efficient producers outside the RTA to preferential trading partners that produce at higher costs. In this case, the government loses tariff revenue on imports from third countries, without domestic producers benefiting to a corresponding extent from lower import prices. The risk for trade diversion to occur is particularly high if MFN tariffs remain high and trade with partner countries accounts for only a small share of overall trade (World Bank, 2004).

These projects contribute to developing trade, both in the services sectors themselves and in other sectors that benefit from the trade enabling role of infrastructure services. However, the harmonization efforts often face implementation problems, despite an important involvement of the international donor community. As a result, the integration process has not been moving very fast, and trade in services remains limited within ECOWAS.

Concerning trade in goods, ECOWAS members have tried to implement a trade liberalization scheme (TLS) since 1990, with the objective of establishing an intra-regional free-trade area by January 2000. Yet, by the end of 2005, only ten members were implementing regional free trade. Nigeria has lagged behind in the regional integration efforts and has maintained import barriers *vis-à-vis* its ECOWAS partners, including import prohibitions. Companies that want to make use of the preferential market access within ECOWAS have to get their products for intra-regional trade listed and approved by a central registry in order to avoid transshipment of third party imports under falsified rules of origin documents. In Nigeria, the Ministry of Cooperation and Integration chairs the National Approvals Committee and serves as the approving authority. By the end of 2005, about 1 500 companies from ECOWAS countries, including 575 Nigerian firms, were included in the Community-wide registry and had on average declared two products each for intra-regional trade.

In order to help members cope with the tariff revenue loss due to the elimination of intra-regional tariffs, ECOWAS countries implement a 0.5 per cent surcharge on all imports from outside the Community. The receipts from this Community Levy are administered by the ECOWAS Secretariat and serve to finance the institutions of the organization, ongoing integration projects, and a revenue loss compensation mechanism. The latter pays members compensation for lost revenues over four years on a decreasing scale: 100 per cent in 2004, 80 per cent in 2005, 60 per cent in 2006, and 30 per cent in 2007. Unlike some other members, such as Benin, Ghana, and Togo, Nigeria has not yet applied for this compensation, despite being the largest financial contributor to the Community budget. According to estimates by the ECOWAS Secretariat, Nigeria might be entitled to USD 13.5 million in compensation over the period 2004-2007 (ECOWAS, 2004). Nigerian officials explain the non-deposition of respective claims with difficulties to provide the required customs documents and the discouragement of long disbursement delays experienced by other members.

The establishment of an ECOWAS customs union and the adoption of a common external tariff was originally planned for January 2002. However, the timetable has not been respected and the target date has been postponed several times and stands now to be January 2008. In order to meet this schedule, Nigeria will have to reduce its special 50 per cent tariffs on sensitive products and phase out any remaining import bans by that date. Meeting this new deadline would be a boost to Nigeria's policy credibility within the region and beyond, and provide a welcome anchor for the new, more open trade policy stance in the face of potential protectionist pressures from interest groups.

4.3 Shaping the EPA negotiations with the EU remains a challenge

As a developing country, Nigeria benefits from preferential market access in industrialized countries. Yet, many of the preference granting programs are limited in duration and are subject to periodic review (Box 5). As a result of such a review, the EU's preferences for its partners in Africa, the Caribbean, and the Pacific (ACP) were renewed in the Cotonou Agreement of 2000. At the same time, it was decided to amend the relationship between the EU and ACP countries and change the existing trade preferences from non-reciprocal to reciprocal in order to ensure full compliance with provisions under the WTO agreement. The conclusion of the intended economic partnership agreements (EPAs) is likely to have major impacts on the ACP countries (Hinkle and Schiff, 2004).

The EPA negotiations started in October 2003 and are supposed to conclude by the end of 2007. In order to facilitate the negotiation process and to enhance the development impact of the agreements through increased intra-regional trade, the EU intends the EPAs to be signed with free trade areas or customs unions rather than individual countries. A West Africa group has constituted itself for the negotiations, which consists of all ECOWAS members plus Mauritania.

The prospective EPA agreement will not improve the preference margins that least developed countries (LDCs), which are eligible for duty and quota free access to the EU market under the Everything-But-Arms initiative, already enjoy in the EU market. In contrast, non-LDCs, such as Nigeria, have higher stakes at play. If no agreement were reached, they would lose their current preferences under the Cotonou Agreement in 2008 and would only be eligible for the less generous GSP. On the other hand, they could somewhat improve their terms of market access through a successful EPA outcome. In 2005, the EU tariff schedule for imports under Cotonou preferences included 451 tariff lines with non-zero duty rates, out of a total of 8310 lines. Some of the products concerned, such as processed mangos or poultry meat, might be of export interest to producers in west Africa (PriceWaterhouseCoopers, 2005). Yet overall, the benefits from lower import tariffs would likely remain limited.

Box 5: Major Preferential Market Access Programs

The *Generalized System of Preferences* is based on the 1979 Enabling Clause that created a permanent waiver to the most-favored-nation provision in the General Agreement on Tariffs and Trade. Under GSP, selected products originating in developing countries are granted non-reciprocal preferences in the form of reduced or zero tariff rates. Least developed countries receive preferential treatment for a wider coverage of products and deeper tariff cuts. GSP schemes represent unilateral preferences that differ in their design and duration across preference granting countries. The following entities currently operate GSP schemes: Australia, Belarus, Bulgaria, Canada, the European Community, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the United States of America.

The *Cotonou Agreement* of 2000 between the EU and 77 African, Caribbean and Pacific countries provides preferential access to the EU market in addition to and beyond GSP. The Agreement grew out of the Lomé Convention that governed the relations between the EU and its former colonies in the ACP region from 1975 until 2000. It grants comprehensive market access preferences and allows partners to count the value-added in imports from other ACP countries as local input when determining the origin of a product (“full cumulation”). However, the EU has exempted bananas, beef, and sugar from the preferential access arrangements. The Agreement has been concluded for twenty years, with a clause allowing for revision every five years. In 2008, the present market access preferences are supposed to be replaced by arrangements to be agreed upon in Economic Partnership negotiations.

The EU’s *Everything But Arms* initiative of 2001 grants duty-free access to imports of all products from least developed countries, except to arms and munitions. Only imports of bananas, rice and sugar were not fully liberalized immediately. Duties on those products will be gradually reduced until duty free access will be granted for bananas in January 2006, for sugar in July 2009 and for rice in September 2009. In the meantime, there are duty free tariff quotas for rice and sugar. The EBA provisions have been incorporated into the EU’s GSP scheme. The rules of origin of the latter allow in four regions in the Caribbean, East Asia, Latin America, and South Asia that intermediate inputs from regional partners are counted as local value-added, if the degree of prior transformation of the inputs would have conferred origin in the regional partner country (“diagonal cumulation”) . Outside these regions, only imported inputs from the EU can be counted towards local value-added (“bilateral cumulation”). The regulation on EBA foresees that the special arrangements for LDC's are to be maintained for an unlimited period of time.

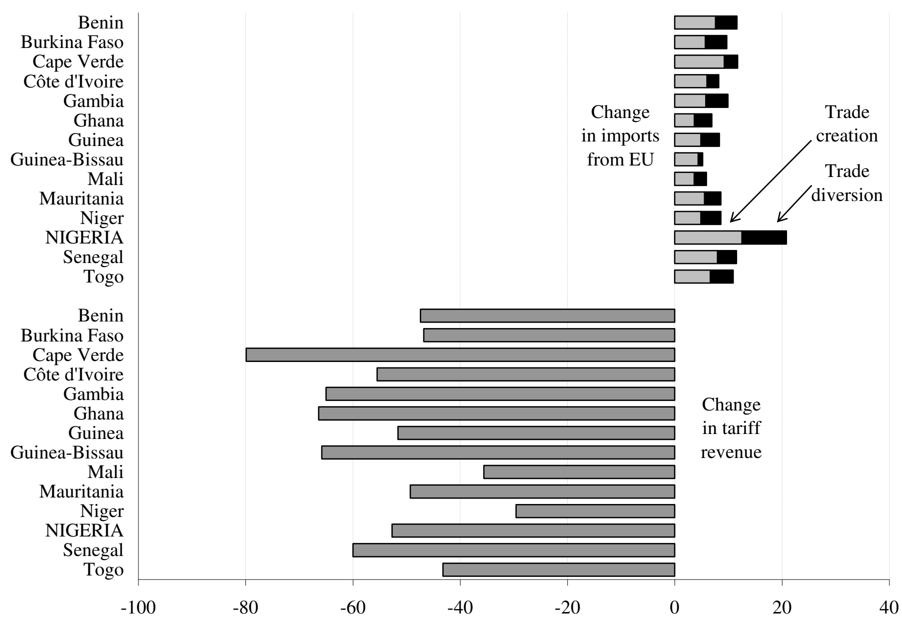
The *African Growth and Opportunities Act* of 2000 extends the GSP scheme of the United States to additional products, notably garments, from African countries that satisfy certain economic, social and political criteria. A special program for countries with a gross national product per capita of less than USD 1500 relaxes the otherwise strict rules of origin for apparel and allows qualifying countries to count yarn and fabric from anywhere in the world as local content in apparel assembled in their countries. AGOA is a time-bound program that requires periodic renewal by the US Congress. The special textile benefits expire in September 2007, while the overall program is scheduled to run until 2015.

Larger benefits seem to be possibly on offer with respect to rules of origin requirements. In particular, the GON might aim in the EPA negotiations to obtain rules of origin provisions that are more favorable than the current Cotonou regulations. For example, if it were possible to negotiate specifications that confer origin based on a simple change of tariff heading or a lower value-added rule, additional market access opportunities for Nigerian exporters could open up.

On the imports side, reciprocity means that over a twelve year transition period from 2008 to 2020, Nigeria would have to open its market to supplies from EU members by phasing out existing trade barriers. This market opening will have the typical effects of preferential trade liberalization, bringing benefits from trade creation and lower consumer prices at the expense of costs related to trade diversion and loss of tariff revenue. Producers will benefit from lower prices on inputs from Europe, but will have to adjust to the more intense competition from EU suppliers.

Quantitative analysis of a prospective EPA in West Africa has been carried out by Busse and Großmann (2004), using on a partial equilibrium model. They assume that West African countries fully open their markets to EU imports, while maintaining their existing trade barriers *vis-à-vis* other trade partners. They find that imports from the EU would increase by 5-20 per cent once the agreement is fully implemented (Figure 27). The trade effects are most pronounced in Nigeria, reflecting the high level of tariff protection in the base period and, hence, the bigger impact of liberalization. Any reductions in external tariffs that Nigeria is undertaking before EPA implementation, including the adoption of the ECOWAS CET, are attenuating the impacts of the EPA itself.

Figure 27: Estimates of the impacts of a prospective EPA on West Africa



Note: Changes relative to the level in 2001 (2000 for Nigeria). Reported results correspond to the medium-impact scenario of the analysts.
Source: World Bank staff based on Busse and Großmann, 2004.

The analysts estimate that 60 per cent of the additional imports from the EU represent newly created trade between Nigeria and western European countries, while the remaining 40 per cent are due to the diversion of imports away from other partners and towards EU exporters due to the differential tariff treatment. Trade creation implies the availability of a greater variety of intermediate inputs and final consumer goods from the EU at lower prices. Hence the Nigerian consumers and users of imported inputs would benefit. Trade diversion, on the other hand, is welfare decreasing because higher cost producers from EU countries displace in this case more efficient sources of imports.

Concerning impacts across sectors, the analysts estimate that the most pronounced changes in West African imports would occur for textiles, apparel and clothing, as well as footwear. To a lesser degree, but still considerably affected would be product groups such as sugars and sugar confectionery, preparations of cereal, flour, starch and milk, essential oils, soap, carpets and textile floor coverage, cars, trucks, motorbikes, furniture, bedding and mattresses, and toys, games and sports requisites. For these products, the changes in imports would be above average (Busse and Großmann, 2004).

There would be significant adverse impacts on tariff revenues in west Africa, with duty collection in most countries dropping by 40-60 per cent. These duty losses consist both of the lost revenues on pre-EPA imports from the EU and on the imports from other countries that are being replaced by duty-free EU supplies. The revenue losses would be attenuated if certain "sensitive" products were to be exempted from the liberalization process. Since Nigeria is not very dependent on trade taxes, the tariff revenue loss would correspond only to 2.5 per cent of total government revenues, while in some other West African countries, such as Cape Verde and Gambia, more than a fifth of all public revenues could be lost.

A subsequent study that used a different partial equilibrium model confirms the direction and general magnitude of the effects of a prospective EPA (UNECA, 2005). Concerning the impacts on Nigeria, the UNECA analysts predict a stronger increase in imports (more than 25 per cent), but a larger share of trade creation (about 78 per cent) in total trade. They also quantify the impacts of an EPA on intra-regional trade and find that some of Nigeria's imports from other West African countries would be replaced by shipments from the EU. Such trade diversion would, however, only account for about 0.5 per cent of the total trade effect. The predicted loss in tariff revenues is similar to the findings in the study by Busse and Großmann.

The coverage of the EPA negotiations is *a priori* not limited to the goods sector, but also embraces services. Discussions in this area, however, are still at a preliminary stage. In July 2005, a joint Technical Negotiating Group on investment and services held its first meeting and decided to commission a study to ascertain: (i) the status quo and obstacles to trade in services in the region, (ii) how to increase competitiveness, and (iii) how the competitiveness issue could be addressed in the EPA negotiations. Yet, the priority sectors and the timetable for the negotiations on EU-West Africa services integration remain to be determined.

Nigeria seems to have been less actively involved in the EPA services negotiations than other ECOWAS members, such as Ghana or Senegal. Also, the exchange of information between Nigeria, other member countries, and the ECOWAS Secretariat concerning the definition of negotiating priorities and strategies seems to be minimal. This lack of dialogue is surprising, given the importance of Nigeria's relations with the EU– about 60 per cent of the country's FDI inflows originate in western European countries. The marginal involvement of Nigerian trade policy makers presents the risk that the outcome of the EPA negotiations might not correspond to the specific needs and interests of Nigeria. There are both Nigeria-specific issues at stake, such as the treatment of oil industry related services, as well as interests that would benefit from the active support of the biggest ECOWAS member, such as attempts to ease EU restrictions on temporary migration. GON might also use the EPA negotiations to lock in and advance reforms of its domestic services sector.

5. WHAT ARE GOING TO BE THE IMPACTS OF GLOBAL TRADE REFORMS?

Nigeria is a member of the WTO and grants its trading partners at least most favored nation treatment. As a developing country, Nigeria is not subject to the same disciplines and obligations as developed WTO members, and the country benefits from special and differential treatment and preferential market access conditions in high-income countries. Multilateral trade negotiations are currently ongoing in the Doha Development Round. The successful conclusion of these negotiations is likely to erode preferential market access for some Nigerian exporters, while opening new opportunities for others.

5.1 Preference erosion is no significant threat

Nigeria benefits from market access preferences under the Generalized System of Preferences, the EU's Cotonou Agreement with African, Caribbean and Pacific Countries, and the USA's African Growth and Opportunity Act. The extent of duty reductions, product coverage, and rules of origin specifications differ across the various arrangements. The potential advantages for Nigeria of these preferential arrangements are considerable, since the country ships most of its exports to preference granting partners.

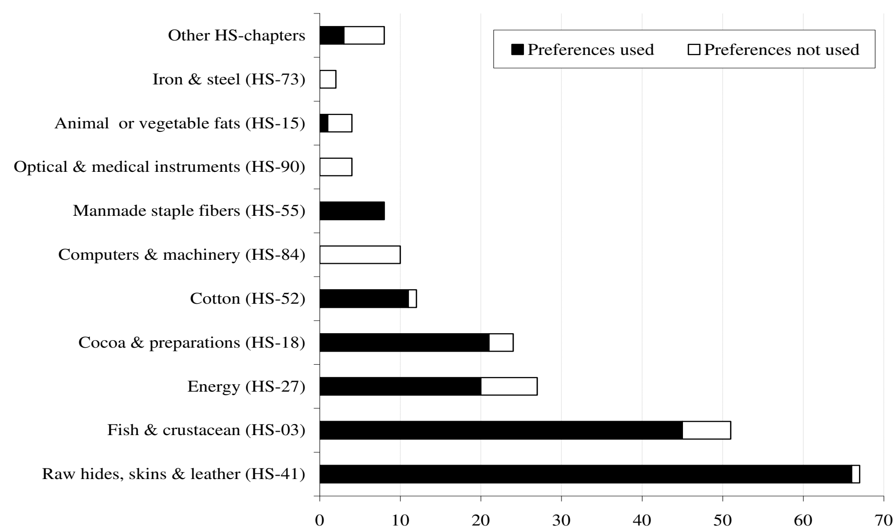
The actual value of the preference schemes to individual developing countries depends on several factors. Obviously, preferences are valuable only if there is a positive preference margin over non-eligible countries' supplies, that is if the importing country has non-zero MFN-duties in the tariff lines of interest. Moreover, the value of preferences depends on the costs involved in showing compliance with rules of origin requirements. If these costs exceed the MFN-duty, exporter will not bother to ask for preferential treatment, but pay the tariff. Finally, the extent of benefits from preferential market access are a function of the volume of goods the country is allowed to export to the target market, for example under preferential tariff rate quotas. Hence, three factors play a crucial role: the available preference margin, the costs of showing compliance with rules of origin requirements, and quantitative supply limits, including those originating from insufficient supply capacities in the exporting country.

In 2003, the value of Nigeria's goods-exports to the EU amounted to EUR 6.1 billion. More than 96 per cent of these exports, mostly fuels, entered the European market at zero-duty MFN rates. Of the remainder, about EUR 218 million were eligible for preferential market access, i.e. were entitled to get zero or reduced duty access in cases where the MFN-rates were non-zero. For 80 per cent of the eligible exports, Nigerian traders made use of these preferences.

Several reasons have been put forward to explain the less than full utilization of preference schemes by developing countries. These explanations focus on the constraints of complying with rules of origin (Brenton and Imagawa, 2004), the costs of satisfying requirements related to certification, traceability and administrative documentation (Estevadeordal and Suominen, 2003), and uncertainty about the applicability of individual schemes (OECD, 2005). The latter explanation seems to be particularly pertinent for small-scale, infrequent shipments to overseas markets.

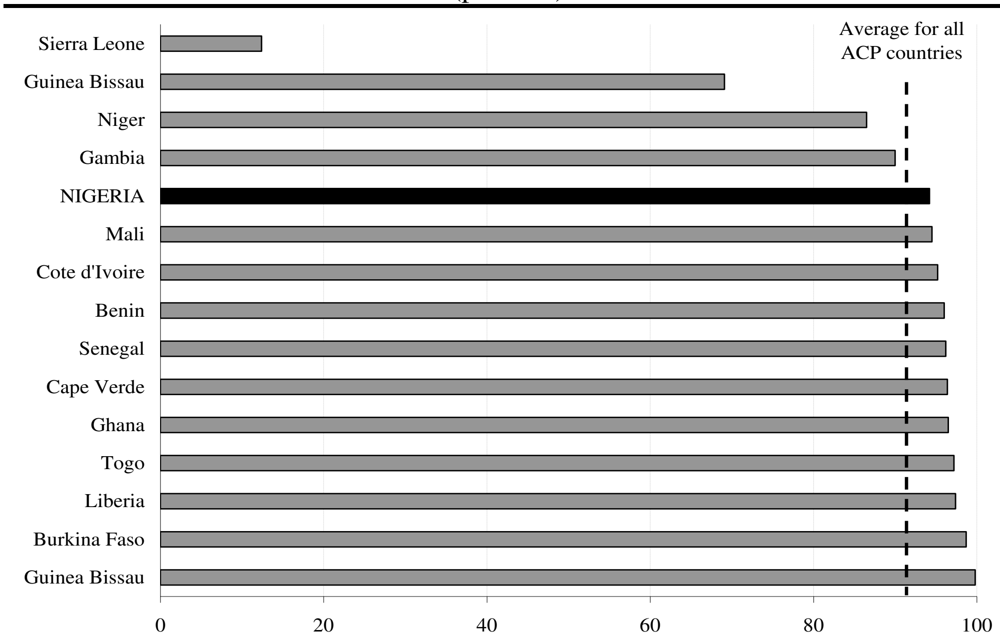
In the case of Nigeria, analysis by product group reveals that preference utilization for agri-food, textiles, and leather products is higher than the 80 per cent average (Figure 28). The relatively high preference utilization level for agri-food products is confirmed in cross-country comparisons, where Nigeria with a utilization rate of more than 94 per cent ranks above the average for all ACP countries (Figure 29). In contrast, Nigerian exporters of computers & machinery, optical & medical instruments, and iron & steel products could not take advantage of the existing market access preferences. Some of the explanations for under-utilization of preferences mentioned earlier might apply. But given that the product categories are rather untypical for Nigeria's exports, the non-attribution of preferences might also just be the result of the products not having undergone sufficient transformation in Nigeria to meet the EU's rules of origin requirements (or merely reflect statistical mis-classification).

Figure 28: Nigerian exports to the EU eligible for preferences, 2003
(million Euro)



Source: European Commission.

Figure 29: Use of ACP preferences for agri-food products in the EU market, 2002
(per cent)



Source: OECD (2005).

Despite the relatively high preference utilization rate in the western European market, Nigeria's share in total preferential trade with the EU is tiny. In 2003, Nigeria's accounted only for 0.13 per cent of all preferential imports into the EU. On first sight, the situation looks fundamentally different for Nigeria's trade with the USA under AGOA (Table 9). In trade flow terms, Nigeria is the biggest beneficiary of AGOA and accounts for more than half of US imports under this preferential scheme. However, almost all of Nigeria's exports to the US are petroleum, the MFN tariff for which is 5.25 US cents per barrel. Hence, the preference margin is miniscule and does not provide any significant incentive effect. Yet, the high volume of shipments means that the value of preferences is non-negligible. For 2002, it amounted to nearly USD 22 million, which put Nigeria into fourth place in terms of total benefits derived from AGOA (Brenton and Ikezuki, 2004). Concerning non-energy exports, Nigeria's shipments to the US amounted to a mere USD 700 000 in 2005, or 0.006 per cent of all US non-energy imports under AGOA. So again, Nigeria has not been able to use its preferential market access to foster economic diversification.

Table 9: US Imports from Nigeria, 2003-2005
('000 USD)

	2003	2004	2005
Total US Imports from Nigeria	10 113 618	16 295 101	23 875 179
- Non-AGOA	757 606	878 497	1 414 562
- AGOA (including GSP)	9 356 012	15 416 604	22 460 617
- Energy	9 353 913	15 415 912	22 459 913
- Agriculture	1 767	226	633
- Other	332	466	71

Source: United States Department of Commerce.

The flip slide of the low use of preferences in the EU and US markets is that Nigeria has little to lose from negotiated tariff reductions in the Doha Round in terms of preferential trade income. Unlike some other developing countries, notably small island economies that rely heavily on sugar, banana and textile exports (Alexandraki and Lankes, 2004), the reduction of MFN tariffs and, hence, preference margins would not lead to major economic impacts on Nigeria. As a result, the country could take an active position in the negotiations with the aim of bringing down tariffs and opening up new potential markets for its exporters, in particular in middle-income developing countries.

5.2 Market access barriers in foreign markets are relatively modest

While preferential trade relations can be advantageous, some objectives can be better achieved at the multilateral level. In particular, adverse effects from trade diversion are avoided, the complexity of trade regulations is reduced, and better market access can be achieved in countries that are unwilling to engage in preferential agreements. Moreover, highly sensitive issues, such as agricultural subsidy reductions in industrialized countries, can only be effectively addressed in a multilateral form. The multilateral trading system also provides a legal framework that treats all members equally, irrespective of their economic status. Nigeria has recognized these advantages and has been participating in multilateral negotiations as a founding member of the WTO.

How important are the tariffs and regulatory obstacles that Nigerian exporters face overseas and that could possibly be reduced as a result of the Doha Round? The Market Access Overall Trade Restrictiveness Index (MA-OTRI) provides an aggregate measure of foreign barriers. It corresponds to the uniform tariff that if imposed by all trading partners on exports of a particular country (instead of the actually applied tariffs and non-tariff impediments) would leave overall exports of that country unchanged (Kee, Nicita, and Olarreaga, 2005). For Nigeria in the early 2000s, the MA-OTRI amounted to 15.1 per cent on agricultural exports and to 2.2 per cent on manufactured products. For all merchandise trade, the indicator value was estimated at 5.9 per cent. Among the 91 countries for which data are available, Nigeria thereby ranks among the countries that are facing relatively low tariff and non-tariff barrier obstacles to their exports.

Nevertheless, in some cases Nigerian exporters encounter significant policy-generated trade barriers that might partly explain their low export intensity. The tariff barriers that some of Nigeria's main export products face can indeed be considerable (Table 10). The duties claimed on imports of fish & crustaceans, cocoa & cocoa preparations, and hides & leather, which are among Nigeria's most important non-oil exports, tend to be particularly high in medium income countries. For example, Taiwan levies a 26 per cent tariff on fish & crustaceans, Ukraine charges import duties of 19 per cent on cocoa and cocoa preparations, and Tunisia asks hides & leather importers to pay duties of 25 per cent. Tariffs on these products in industrialized countries are generally much lower and of a single digit magnitude. Moreover, industrialized countries grant developing countries, such as Nigeria, preferential market access (see section 5.1), so that Nigerian exporters only pay the full MFN-duties if their shipments do not qualify for preferential treatment, perhaps due to problems of showing compliance with rules of origin requirements.

In any case, one impediment to improved export performance that low-income countries like Nigeria face despite relatively low average export barriers is related to the tariff structure in partner countries. Many countries have escalatory tariff regimes, with low duties on raw materials, but higher ones on semi-processed and processed products. This encourages imports of unprocessed goods, often from low-income countries, which are then transformed in the importing country under high protection. For the raw material exporter this tariff escalation means that value-addition before exports is discouraged, as processed products face high tariff barriers in foreign markets. Hence, the diversification process into higher value-added production activities is impeded.

It should be noted that preferential access for developing countries to high-income country markets will tend to neutralize the effects of escalatory MFN-tariff regimes in these countries. However, in many cases, rules of origin provisions on processed goods are more complicated or more difficult to meet than the rules on raw materials of unfinished products (Carrère and de Melo, 2003). For example, it has been estimated that the costs of compliance for food products are more than twice as high as those for agricultural commodities (OECD, 2005). Such "rules of origin escalation" will tend to have qualitatively the same adverse effects on developing countries' efforts to shift into higher value-added production as tariff escalation.

There are other non-tariff impediments to developing country exports, notably in the area of sanitary and phyto-sanitary (SPS) and other technical standards. In response to heightened consumer and agro-industry concerns about food safety and agricultural health, industrialized countries have adopted more stringent SPS import requirements over time. As a result, agriculture and food producers from developing countries may experience increasing difficulty of entering export markets if they do not comply with international trading rules or voluntary, private standards, such as supermarkets' assurance schemes.

In 2004, the EU's Rapid Alert System for Food and Feed issued 17 alert and information notices concerning products from Nigeria, which corresponded to 0.7 per cent of all notices. The available information for 2005 indicates that both the absolute number of notices concerning Nigerian products and their relative share of the total have risen. Many of the recent alerts concerned elevated aflatoxin levels in melon seed or the presence of unauthorized Sudan-4 color in palm oil. These indications point to quality assurance problems in the processing of agricultural products for export.

Table 10: Average of MFN barriers in potential partner countries for major non-oil exports from Nigeria (per cent)

	Fish & crustacean		**Cocoa & preparations**		**Hides, skins & leather**	
	Simple Average	Weighted Average	Simple Average	Weighted Average	Simple Average	Weighted Average
Argentina	..	..	15.1	14.0	..	..
Australia	0.0	0.0	2.3	2.5	..	..
Brazil	9.3	7.2	15.1	12.7	7.5	8.4
Bulgaria	..	..	..	..	3.1	4.9
Canada	0.4	0.3	3.0	3.0	1.3	1.9
China	11.7	10.5	11.0	10.4	10.0	6.8
Croatia	..	..	..	..	1.4	0.0
European Union	9.3	10.3	6.1	2.2	2.3	2.4
Ghana	9.5	5.0	..	..	..	..
India	..	..	..	..	11.1	12.3
Indonesia	4.9	5.0	..	..	..	..
Israel	5.6	2.3	0.4	1.5	1.1	0.7
Korea, Republic	16.0	13.6	7.2	8.4	4.5	3.7
Malaysia	1.2	0.4	13.0	1.6	0.8	0.0
Mauritius	9.0	1.8	..	..	..	..
Mexico	16.4	16.8	16.8	19.7	8.4	9.4
New Zealand	..	..	3.0	4.5	..	..
Norway	0.0	0.0	0.0	0.0	..	..
Romania	..	..	..	..	8.8	5.3
Russian Federation	10.1	10.0	5.6	6.8	8.8	5.3
Saudi Arabia	..	..	10.1	17.3	..	..
Singapore	0.0	0.0	0.0	0.0	0.0	0.0
South Africa	..	..	..	..	3.7	5.9
Switzerland	0.0	0.0	0.0	0.0	..	..
Taiwan, China	25.7	21.8	..	..	0.8	0.5
Thailand	8.3	5.2	12.6	20.7	3.6	3.3
Tunisia	..	..	..	..	24.8	23.8
Turkey	..	..	9.0	1.3	..	..
Ukraine	..	..	18.8	9.0	..	..
United States	0.6	0.4	3.3	2.9	2.2	2.8
Vietnam	29.5	29.7	..	..	4.8	7.7

Note: (..) means that the country is not among the world's top-twenty importers of the respective products. Averages across all tariff lines in the respective HS-chapter. Data for 2005 or latest year available. Japan not included, as the country charges non ad-valorem duties on imports in the three HS-chapters.
Source: World Bank staff based on UNCTAD Trains database.

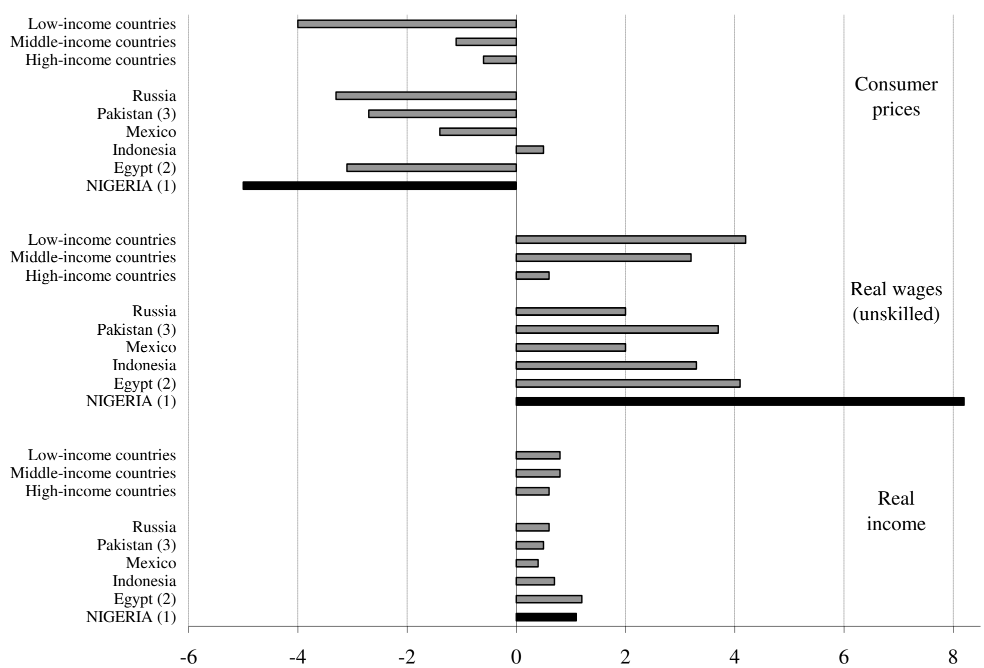
With respect to the North American market, the US Food and Drug Administration rejected 36 shipments from Nigeria over the period from April 2005 to March 2006. Many of the rejections concerned pharmaceutical products that were not authorized for sale in the USA. In addition, there were a number of cases in which shipments were not accepted due to filth or incorrect or incomplete labelling. Hence, exporters do not always seem to be aware of the formal technical requirements for imports into the USA, or do not always process and handle their produce in a way that ensures that it arrives in good condition in the destination country.

While SPS and other technical requirements might in some cases be excessive and represent non-tariff barriers aimed at shielding industrialized country producers from international competition, most food safety standards are based on legitimate domestic policy objectives and do not discriminate between domestic producers and imports from developing countries. The possibilities for developing countries of negotiating more lenient standards seem, therefore, limited, and developing country exporters will have to comply with the destination country standards, if they want to supply the respective markets (World Bank, 2005c). In cases where SPS requirements are not based on international standards or scientific risk assessments, the WTO Agreement on Sanitary and Phyto-sanitary Measures provides a framework to address pertinent trade concerns, including dispute settlement procedures.

5.3 A successful Doha Round outcome would complement domestic reforms

Multilateral reductions in tariffs and non-tariff barriers, as under discussion in the Doha Round of WTO negotiations, will tend to erode Nigeria's (modest) tariff preferences, while reducing (modest) trade barriers in overseas markets. What will the overall impact on the country be? Full liberalization of merchandise trade has been estimated to result in world-wide real income gains of almost USD 300 billion (Anderson, Martin and van der Mensbrugghe, 2005a). About 70 per cent of these income increases would be realized in high-income countries, and about 30 per cent in developing countries. However, in relative terms, the gains are more substantial in low income countries, and especially in sub-saharan Africa, than in middle or high-income countries (Figure 30).

Figure 30: Impacts of full liberalization of world merchandise trade
(per cent change from pre-liberalization baseline)



Note: (1) includes other countries in West, Central and East Africa; (2) includes other countries in the Middle East and North Africa; (3) includes other countries in South Asia, except Bangladesh and India.
Source: Anderson, Martin and van der Mensbrugghe, 2005a.

The exact impact of the Doha Round on Nigeria will, of course, depend on the outcome of the negotiations. Recent model-based analysis of the economic effects of alternative Doha trade liberalization scenarios suggests that Sub-Saharan Africa (SSA) could more than proportionally gain from multilateral reform, but that countries will need to take a proactive stance in the negotiations to secure a positive outcome (Anderson, Martin, and van der Mensbrugghe, 2005b). Opening agricultural markets in industrialized countries is projected to result in large benefits for poor African countries, but the reductions in agricultural tariffs, domestic support and export subsidies need to be ambitious. Exempting even just a few "sensitive" or "special" products could reduce hugely the gains from reform, since these products are likely to be the tariff peak items.

Expanding non-agricultural market access at the same time as reforming agriculture is equally important for SSA. Such reforms in manufacturing and services, including in developing countries, are needed in order to improve the prospects of concessions by industrialized countries concerning agriculture, and to obtain greater efficiency gains in SSA. The latter are important to offset the terms of trade losses suffered either by net food importers or by recipients of tariff preferences. South-South concessions in the form of own reforms also are needed for developing countries to get the most out of the Doha round. Since developing countries are trading quite intensively with each other, they would be the major beneficiaries of reforms by other developing countries.

How would Nigeria's own trade regime be affected by an ambitious outcome of the Doha round? Nigeria currently has tariff bindings in 19.2 per cent of all of its tariff lines (WTO, 2005). All agricultural lines are bound, while bindings exist only for 7 per cent of non-agricultural lines. Final bound tariffs range from 40 per cent to 150 per cent. Nigeria's bound rates, as well as those of its ECOWAS partners, are thereby generally well above the corresponding applied tariffs (Table 11), so that significant binding overhang exists. Hence, Nigeria could offer in the Doha negotiations to significantly expand its binding coverage and reduce existing bound rates, without necessarily facing major adjustments in its trade regime and domestic economy. Indeed, increasing the binding coverage and reducing binding overhang would increase the predictability of Nigeria's trade policy and enhance the credibility of the country's commitment to international integration *vis-à-vis* its trade partners. As a result, the latter might be more willing to engage in commercial transactions with Nigerian counterparts. Further reductions in the applied common external tariffs might be desirable in order to reap benefits from a more open trade regime, but such a liberalization would likely not be forced on Nigeria and its ECOWAS partners by the outcome of the Doha negotiations, but remain in its extent and timing subject to unilateral policy decisions.

Similar negotiating space exists with respect to services. At the end of the Uruguay Round negotiations in 1994, Nigeria made specific commitments in four services sectors, namely communication services (telecommunications), financial services (banking), tourism and travel-related services, and transport services (maritime and rail transport). In addition, Nigeria scheduled horizontal restrictions on commercial presence and movement of natural persons. Moreover, in 1998 Nigeria accepted the Fifth Protocol to the GATS on financial services, adding commitments on insurance services and making improvements to its earlier commitments on banking services.

Since Nigeria made these commitments, the government has engaged in a number of important reforms in the services sectors, including privatizations and revisions of some legal and regulatory frameworks. As a result, Nigeria has liberalized further than it was legally bound to do under the GATS. This 'under-commitment' is a common pattern for many countries, but Nigeria could use the resulting margin of maneuver to its best interest in the current Doha Round. Since the beginning of the Round, Nigeria has received GATS requests from nine other WTO members

(Australia, Canada, China, Egypt, the European Union, Norway, Panama, South Korea, and the United States), but has itself not made any offer yet. Once again, this is a common pattern for developing countries, which tend to try to free-ride on the offers of the major trading countries.

Table 11: WTO Tariff Bindings of ECOWAS Members

Country	Number of bound tariff lines (HS-6)	Minimum binding (%)	Simple average of bindings (%)	Maximum binding (%)
Benin	2053	0	28	100
Burkina Faso	2046	0	41	100
Côte d'Ivoire	1880	0	11	64
Gambia	684	20	101	110
Ghana	717	30	92	99
Guinea-Bissau	4902	40	49	50
Guinea	2036	0	20	75
Mali	2370	0	29	75
Niger	5030	0	44	200
NIGERIA	**954**	**40**	**119**	**150**
Senegal	5115	15	30	30
Sierra Leone	5113	30	47	80
Togo	715	80	80	80

Note: The ECOWAS members Cape Verde and Liberia are not members of the WTO.
Source: World Bank staff based on WTO Consolidated Tariff Schedules database.

Yet, Nigeria could use some GATS commitments as free bargaining chips. Further commitments could be made at no or very little cost to Nigeria. Many requests addressed to the country actually seek no more than the preservation of the *status quo* and the clarification of existing commitments. In some cases, Nigeria commitments just need to be reviewed in order to reflect the conditions already prevailing on the domestic market. For example, in the telecommunications sector, the Nigeria schedule of commitments gives *NITEL* privileges that are now obsolete. Also, in the maritime transport sector, the inadequate number of national shipping companies makes it impossible for Nigeria to make full use of its scheduled shipping rights.

Nigeria would itself benefit from new commitments, because it would allow the government to anchor its ongoing reform process into the GATS framework and protect its achievements against political instability or interest group pressure. From a business perspective, the set of new GATS commitments would improve the investment climate by reinforcing predictability and the stability of the regulatory environment. This can be a significant advantage in a world where many countries compete for foreign investment.

Nigeria also has offensive interests in services trade, in particular in sectors where it performs relatively well (e.g. banking, telecoms, transport). Considering that the ECOWAS Treaty does not ask member states to suppress barriers to trade in services, the GATS negotiations could be a tool to gain access to regional markets. Finally, since Nigeria has a large and relatively well qualified labor force, it has a strategic interest in the horizontal liberalization of the movement of natural persons, in particular *vis-à-vis* the US and the EU.

6. HOW IS TRADE LIBERALIZATION AFFECTING THE POOR?

Like other policy reforms, trade policy changes affect different groups in society to a differing extent. The impacts on poor households are thereby of particular interest for policy makers. Recent World Bank analysis of experiences in several countries indicates that the near term effects are very case specific and are mixed in terms of their outcomes, with poverty rising in some cases and falling in others (Hertel and Winters, 2005). In the long term, sustained poverty reductions depend on stimulating economic growth. Here, the impact of trade policy on productivity and investment is critical, and greater openness is generally associated with higher productivity, larger investment, and stronger growth.

6.1 Poverty impacts depend on the availability of market opportunities

Key determinants of the near term poverty impacts of trade reforms include the extent to which world prices are transmitted to rural households, barriers to the mobility of workers between sectors of the economy, as well as the incidence of national tax instruments used to replace lost tariff revenue. With a majority of the poor in most countries located in rural areas and often being poorly served by transportation and communication infrastructure, it is important to ask whether developments in international markets will really have an impact on these households. Of course, this is an empirical question. Econometric investigation for the case of Mexico shows that indeed world prices are differentially transmitted to the regions of the country, depending on their distance from the border and the nature of the commodity in question (Nicita, 2004). For manufactured goods it is found that about two-thirds of international price changes pass through to the domestic market, whereas the comparable figure for agriculture is just one-quarter.

The main resource with which the poor are endowed is their own labor. Whether they are self-employed farmers, providers of services, or wage earners, their income is closely tied to conditions in the labor market. Robilliard and Robinson (2005) explore the poverty impacts of trade reform under alternative labor market conditions in Indonesia. They find that the largest reduction in poverty comes under conditions in which wages are flexible and workers can easily switch between sectors. The proportional reduction is slightly higher in rural areas and more favorable to the poorest of the poor as well. When labor is not permitted to move across sectors, the poverty reduction effect is a third smaller, as the economy is not able to fully adjust to the new world prices. Efficiency gains are blunted and the national rise in per capita income is muted.

Another important issue in the analysis of linkages between trade reform and poverty is the way in which potential tariff revenue losses are replaced and the impact of the replacement taxes on the poor. Analysis of a prospective Doha Round liberalization for Cameroon suggests that replacement of lost tariff revenues through a value-added tax would lead to a slight fall in poverty and inequality (Emini, Cockburn and Decaluwé, 2005). If a more far reaching liberalization is considered, tax replacement becomes much more difficult and the analysts project that poverty would rise, but the size of the poverty increase varies with the choice of the replacement tax. A non-distorting production tax is found to be superior in its distributional impacts compared with a value-added tax or a consumption tax. Hence, in this case, the choice of tax instrument used to replace the lost tariff revenue is crucial.

6.2 Nigeria's ongoing reforms promise to have positive distributional effects

Predicting the effects of Nigeria's ongoing trade reform on income distribution is a complex and challenging undertaking. The extent to which trade policy changes alter the prices of goods and services that are produced and consumed by poor households will naturally have a major impact on poverty levels. Moreover, price transmission, labor market flexibility, and the incidence of replacement taxes will have to be taken into account, although tax replacement is likely to be of lesser significance than in many other developing countries given Nigeria's relatively minor dependance on trade taxes.

Nigeria's Federal Office of Statistics carried out a household survey in 2004 and found that the prevalence of poverty in the country had fallen over time, but that more than half of all Nigerians continue to live with less than one US dollar per day to spend (Federal Office of Statistics, 2005b). Like in many other countries, the share of households living in poverty is higher in rural (61 per cent) than in urban areas (40 per cent). Some insights into how poor households will likely be affected by ongoing trade reforms can be obtained by assessing the impact of liberalization on the production and consumption patterns of the poor.

Very poor households tend to consume a relatively large amount of food that they produce themselves, instead of relying on the market. But in general, poor people spend a larger share of their monetized income on food than richer households. In Nigeria, the richest quintile of households devotes less than 43 per cent to food purchases, while poorer households spend up to 60 per cent on food (Table 12). Hence, any change in food prices will have a more pronounced impact on poorer than on richer households. The earlier analysis of tariff changes due to the adoption of the ECOWAS-CET revealed that average import duties on agricultural products will fall from 41 per cent to 13 per cent, while duties on manufacturing goods will fall from 28 per cent to 12 per cent. Even if price transmission for agricultural products is somewhat lower than for non-agricultural goods, agriculture and food prices should likely decrease by more than non-food prices, thereby increasing the purchasing power of the poor by relatively more than that of richer households.

Table 12: Structure of annual household expenditure by income quintile, 2004 (in NGN)

Income quintile	Total per capita expenditure	Per capita non-food expenditure	Per capita food expenditure	Share of food in total expenditure (%)
1	7 226	3 520	3 706	51.3
2	13 263	5 467	7 796	58.8
3	19 234	7 572	11 663	60.6
4	28 261	11 880	16 381	58.0
5	68 952	39 543	29 408	42.6
Average	35 600	18 506	17 094	48.0

Source: Federal Office of Statistics (2005b).

On the production side, the household survey reported substantial differences in the type of crops that different households grow. There are two crops (eggplant and tobacco), which are to more than 50 per cent grown by households in the poorest quintile. Conversely, there are three crops (coconut, papayas, and pineapple) that are to about or more than 50 per cent planted by the richest quintile of households. Neither eggplant nor tobacco are subject to import prohibitions, while coconut, papayas and pineapple all are. Moreover, the tariff protection for tobacco under the old national tariff schedule (import duty of 15 per cent) and the CET (5 per cent) is substantially below the average for agricultural products, while coconut, papayas and pineapple each benefit from very high protection under the old (import duty of 100 per cent) and new import regime (20 per cent). These observations suggest that rich households have been able to influence the political process in a way that the structure of domestic market protection favors their interests rather than those of the poor. In this context, the full adoption of the CET and the phasing out of import prohibitions will reduce the anti-poor bias in the trade regime and put poor household-producers on a more equal footing with their richer counterparts in terms of the policy-generated transfers they receive.

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