Economic Implications of the African Continental Free Trade Agreement (AfCFTA) on the Nigerian Industrial Sectors
Introduction

Global trade has witnessed drastic changes in the last two decades. The world trade paradigm has been increasingly marked by trade integration and the immense use of unilateral trade measures. It is by no surprise that the African Union (AU) Assembly of Heads of State and Heads of Government in 2012 saw the urgent need to create a continental free trade agreement, which essentially aims to reposition the African continent for improved intra-African trade as well as improving its trade with the rest of the world. The creation of African Continental Free Trade Agreement (AfCFTA) through series negotiations on the liberalisation of trade in goods and services in Africa, represents an ideal measure and a unique collaborative effort by African countries to bolster regional and continental economic integration.

The AfCFTA is of major significance for the African continent. The framework for the establishment of the AfCFTA together with three Protocols (on trade in goods, trade in services and dispute settlement) was adopted by 44 African countries at the AU Assembly on 21 March 2018 in Kigali, Rwanda. Effectively, the AfCFTA entered into force on 30 May 2019, after the condition for the deposit of a minimum of 22 instruments of ratification was met. On July 8, 2019, Nigeria signed up to the AfCFTA. At the achievement of the recent milestone, the AfCFTA becomes one of the flagship projects of the First Ten Year Implementation Plan under the African Union (AU) Agenda.

The initiative presents major opportunities to boost intra-African trade. Some of its objectives aim to create a single continental market for goods and services, with free movement of business persons and investments, as well as enhance competitiveness at the industry and enterprise level through exploiting opportunities for scale production, continental market access and better reallocation of resources. There is no doubting the claims that the AfCFTA can support the realisation of the continent's economic progress. It is expected to be a game-changer for Africa and a key engine of economic growth, industrialization and sustainable development of the entire continent.

With these expectations, proponents have projected various impact that AfCFTA would have on the African continent. Many of the projected estimates have painted a rosy picture of African-wide benefit of AfCFTA. For instance, the IMF projected that, with full implementation of AfCFTA, intra-African trade will rise from $50 billion to $70 billion by 2040, compared to an Africa without the agreement. The line of argument is that the implementation of AfCFTA will ultimately lead to more efficient goods and labour markets in Africa and in turn, such development will significantly increase the continent’s overall ranking on the Global Competitiveness Index. In a report published by Brookings Institute, it has been estimated that Africa will have a combined consumer and business spending of $6.7 trillion in 2030 as a result of the implementation of AfCFTA. In terms of employment growth, the manufacturing industry is expected to benefit
the most from AfCFTA. The consensus narrative is that the AfCFTA could arguably improve the industrial production and technology content of African exports, as intra-African trade is expected to bring about a higher skill and technology transfer than Africa trading with other continents. In all of this context, liberalisation of trade within the African continent has merits and so do AfCFTA.

**While these potential impacts are causes for celebration, the central question to ask is: what is the Nigeria's stake in the accruing benefits of AfCFTA** and what are the effects of the AfCFTA be on the Nigerian industrial sectors, especially given the country's weak non-oil export capacities, infrastructure deficits and a host of other trade-related shortcomings. There are some general concerns among sceptics that Nigeria's membership to the AfCFTA will expose all sectors of the economy, especially non-oil industrial sectors to intense competition from better-positioned enterprises from other African countries. It has been argued that some of the concerns might be mitigated by a carefully calibrated schedule of tariff concessions. The negotiations on such tariff concessions need to be concluded and the outcomes would have to be incorporated in the agreement.

**While the AfCFTA itself has been signed, the parties have yet to negotiate the tariff concessions. Such an effort should rely on country-specific trade-offs,** in terms of potential gains and losses. The widely used impact figures for the effect of AfCFTA are drawn from the continent-wide studies. Such a measurement masks the distributional impacts of tariff liberalisation under AfCFTA between as well as within countries in terms of economic sectors. It is clear that Nigeria needs a sector-wide impact assessment of AfCFTA on its economy. Since the implementation of AfCFTA is yet to kick-off, the potential distribution impacts can only be estimated on the basis of models. The most often used type is the so-called Computable General Equilibrium (CGE) model.

Using a Nigeria-based CGE model (NESG GEMOD), this policy brief provides an analysis of the potential impact of AfCFTA on the Nigerian industrial sectors. The objectives are aimed at:

- ascertaining which of the Nigerian industrial sectors would gain/loss as well as factors reallocations resulting from the trade agreement;
- determining the magnitudes and direction of impacts on key sectoral economic indicators;
- determine if government intervention, by way of an increase in its infrastructure spending and addressing the myriad of bottlenecks in local production, will help improve any potential gains or minimize losses associated with AfCFTA implementation.
Nigerian Industrial Sectors and Existing Barrier to External Trade

**Nigeria trade has been on the rise.** Despite the recent economic recession, Nigeria’s total merchandise trade between 2016 and 2018 stood at N72 trillion relatedly match-up to the trade level before the recession between 2012 and 2014. Of this amount, the export component was N40.6 trillion, representing 56.3% of merchandise trade transactions within the three years. Import components show a remarkable increase in the period. Between, 2016 and 2018, import of tradable goods increased to N31.5 trillion, almost doubling the N19.9 trillion recorded between 2012 and 2014. The expansion of trading activities with the external sector has been supported by oil prices recovery, stable domestic oil production volume, and stronger FX market conditions.

**Figure 1: Nigeria’s Total Trade with Africa vs Rest of the World (2012 – 2018)**
However, Nigeria’s trade with African countries is relatively low. Unlike how the country has established stronger trade ties with Asia, Europe, and North America, Nigerian does not have an economy well-integrated into African trading hubs in terms of primary goods and value-addition. Between 2012 and 2018, only 9% of Nigeria’s total trade was conducted within the continent. Whereas Nigeria’s trade with other regions such as Europe and Asia was 40% and 30% of total mercantile trade respectively and in all, about 91% of Nigerian trade takes place outside Africa.

**Figure 2: Nigeria’s Trade Balance by Goods (2012 – 2018)**

Likewise, the composition of trade is largely skewed to crude oil and other primary goods. Nigeria’s trade in goods is dominated by crude oil and oil-related products. Oil industry products represent about 67% of Nigeria total trade, and of which 71% of the transaction are crude oil trades. At the same time, non-oil industrial goods (manufactured goods, solid minerals, energy goods) account for 25% of Nigeria’s total mercantile trade. While Nigeria is a net crude exporter to Africa and the rest of the world, the same does not hold for non-oil industrial goods and primary goods while mainly associated with agricultural products and other raw materials. In the case of non-oil industrial goods, Nigeria is a net importer. Between 2016 and 2018, Nigeria’s non-oil industrial good traded in deficit to the tune of N11.3 trillion.

This is not surprising for an economy such as Nigeria’s characterised by low industrial base and value addition. But it does present an opportunity for the economy. In 2018, the non-industrial sector accounts for 15% of GDP and its growth only averaged 2.4%. The low level of industrial activities and the value addition taking place within Nigeria suggest that much of the manufactured goods must be imported from abroad. Why this reality may seem to be a problem, it also presents an opportunity for Nigeria. In the same context that Nigeria has a low industrial base and value addition, so do nearly 90% of African countries. If Nigeria can effectively position the priority of its industrial sector for integration into African markets, this could potentially provide a larger market to support the expansion of production and investment across the industrial sectors. That said, it means that government has to be prepared to address the myriad of long-standing structural problems inhibiting real sectors of the economy.
About the AfCFTA and its Potential Benefits

The AfCFTA is a culmination of efforts that build on negotiations of the Tripartite Free Trade Agreement (TFTA). It is an attempt by African Governments to unlock Africa's tremendous potential to deliver prosperity for all Africans. Specifically, it is aimed at:

- Creating a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of the Continental Customs Union and the African Customs Union;
- Expanding intra-African trade through better harmonization and coordination of trade liberalization and facilitation regimes and instruments across RECs and across Africa in general;
- Resolving the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes; and
- Enhancing competitiveness at the industry and enterprise level through exploiting opportunities for scale production, continental market access and better reallocation of resources.

Various studies have drawn out the major benefits expected to emerge from the AfCFTA, including boosting trade, welfare gains and fostering a vibrant and resilient African economic landscape. From the standpoint of various reviews, it is clear that the AfCFTA could serve as a springboard for more beneficial integration of Africa into the global economy. In a study conducted by IMF, for instance, it is estimated that widespread integration of trade in goods could raise the share of intra-African trade in total African trade from about 10.2% to 15.5% in a space of twelve years. This share could be further increased to 22% with the improvement of trade facilitation measures backed by rules of origin compatible with African productive capacity; transportation linkages and customs clearance for intra-African trade.

Different theories have been used to explain the motives behind AfCFTA such as the theory of comparative advantage and the theory of contracts. The proponents support African trade integration have used this concept to trace the transmission mechanism of trade agreements. By agreeing to regional trade integration, economic sectors are expected to gain from economies of scale and access to a large continental market, resulting in increased competitive pressure that can improve firms' efficiency over the long-term horizon. This is because, with trade integration, countries are forced to introduce technical expertise to their production processes, enhance domestic productive capacity, improve institutions, promote an upward harmonization of standards and thereby increase preferential access to desired markets. In the long run, the trade...
Methodology and Scenarios Setting

To quantify the economic impact of the full implementation of AfCFTA on Nigeria’s industrial sector, this report relied on data and estimates of NESG GEMOD to achieve its objectives. The NESG GEMOD is a recursive-dynamic Computable General Equilibrium (CGE) model of the Nigerian economy designed to also capture the dynamic impacts of the AfCFTA. Since the implementation of the AfCFTA agreements will be spread over a period of time, the model is set to estimate the effect of policy changes that may occur in a ten-year period. The analysis was done under 4 policy simulation scenarios including:

- **Scenario 1**: linear cut in tariff over the ten-year AfCFTA implementation period;
- **Scenario 2**: linear cuts in tariff combined with 10% of locally produced substitutes categorized as sensitive goods and protected from liberalization,
- **Scenario 3**: linear cuts in tariff combined with 10% exogenous increase in liberalization will lower trade costs and provide access to a greater variety of products for consumers at lower prices. The caveat is that market consolidation may arise when smaller firms are exposed to stiffer competition.

Other studies have noted that the winners in the trade agreements will be Africa-owned companies who are able to enter new markets. Economic growth will also expand as manufacturing and industrialization become bigger due to the net inflow of foreign investment. In the same vein, there will be lower input costs and increased efficiency since the agreement will ease imports of raw materials with multinational firms partnering with domestic firms to develop raw materials and engage in technology transfer. Moreover, there are expected potential losses in trade integration which involve the challenge in harmonizing Africa’s heterogeneous economies under one agreement and the increased competitive pressure it may generate.

On the last note, few studies have used the concept of trade creation and trade diversion to estimate the likely impacts that the AfCFTA will have on an economy. With a tariff elimination in the tripartite free trade agreement, simulation result from such studies pointed out that the manufacturing sectors will benefit the most from AfCFTA, especially the processed food, light and heavy manufacturing industries. In other impact assessment studies on AfCFTA, the largest employment growth rates are found in the manufacturing industry followed by some services and agriculture subsectors. This represents a valid argument considering that AfCFTA is expected to improve the skill and technology content of intra-African trade than Africa’s trade with others outside of the continent. In this context, AfCFTA has merits.

**Evaluating the Impact of AfCFTA on Nigeria’s Industrial Sectors**

**Methodology and Scenarios Setting**

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government investment;

- **Scenario 4**: linear cut in tariff combined with a 5% increase in labour supply and a 5% increase in foreign capital inflow.

### Table 1: Simulation Scenarios

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Explanation</th>
<th>Period 1 0 - 5 years</th>
<th>Period 2 5 - 10 years</th>
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</thead>
<tbody>
<tr>
<td><strong>Simulation 1</strong></td>
<td>Linear cut in tariff</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Simulation 2</strong></td>
<td>Linear cut tariff + 10% special products</td>
<td>45%</td>
<td>45%</td>
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<tr>
<td><strong>Simulation 3</strong></td>
<td>Linear tariff cut + 10% increase in government investment</td>
<td>50% + 10% ↑ in G investment</td>
<td>50% + 10% ↑ in G investment</td>
</tr>
<tr>
<td><strong>Simulation 4</strong></td>
<td>Linear tariff cut + 5% increase in labour supply + 5% increase in foreign capital inflow</td>
<td>50% + 5% ↑ in LS + 5% ↑ in FS</td>
<td>50% + 5% ↑ in LS + 5% ↑ in FS</td>
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### Macroeconomic Impact of AfCFTA on Nigeria’s Industrial Sector

The discussion of results focuses on changes in key macroeconomic indicators - such as employment, output, investment, import and export - for the Nigerian industrial sectors. Overall, the macroeconomic effects of linear elimination of tariff alone and/or a 90% reduction in tariff and adding 10% tariff on sensitive products (simulation 1 & 2) would have a negligible impact on the Nigerian industrial sectors. While the two simulations resulted in having negative effect on investment, output and employment; their effects altered into small positive changes for both the export and import activities of the sectors (see figure 3). For the two scenarios, the highest positive effect is reflected in the import transaction of the sectors over the 10 years, which increases by 0.13% in the second phase of tariff elimination between 5 to 10 years of AfCFTA implementation (See figure 3). This is consistent with the fact that Africa accounts for a relatively small fraction of Nigeria’s overall external trade.

### Figure 3: Effect of AfCFTA on Nigerian Industrial Sectors
The industrial sectors in Nigeria will lose out in all segments when the government eliminates tariff completely and at the same time attempts to cushion the economy by increasing expenditure by 10%. In this case, all indicators including investment, output, employment, import and export of the industrial sectors decline over the 10-year period. Investment declines by an average of 1%, sectoral GDP drops by 0.4%, export by 1.3%, and import by 0.1%. The industry employment rate suffered the most with a decline of 2.6% in the period 5 to 10 years and an average decline of 1.7% over the 10-year period. The result is not surprising within the context, as government investment spending has been proven to be underperforming historically and not having a significant impact on economic growth.

From the simulation result in scenarios 1 & 2, eliminating tariff alone, have some negligible positive effects on the Nigerian industrial sector. However, combining such a measure with an increase in government investment will not result in any effect for the industrial sectors. This is because the revenue losses resulting from the reduction in tariff is not being compensated for by the expected level of expansion in local industrial activities. The general assumption is that AfCFTA should automatically spur expansion in economic activities. However, there are long-standing non-tariff barriers that represent a critical obstacle to the competitiveness of the Nigerian industries. Large infrastructure gaps, significant trade-related transaction costs and difficult business environment are some of the biggest problems to tackle head-on if Nigeria's industrial sectors were to benefit from AfCFTA implementation.

If the government can tackle the myriad of structural challenges and make the economy conducive for private investment to thrive, the industrial sectors will benefit a great deal from the AfCFTA. This is particularly reflected in the result of the fourth simulation where the tariff is phased out over a 10-year period, and
assuming that AfCFTA would bring about 10% increase foreign investment and 10% increase in technical labour supply in the economy. Under this scenario, all indicators (except employment) show an appreciable positive effect of AfCFTA. Investment and import will increase by 5.9% and 1.7% in the 10-year period. After a decline of 1.8% in the first five years, industrial output is expected to expand by 1.4% in the later period of 5 to 10 years. It is important to note that, the increase in importation from African countries as a result of the implementation AfCFTA is not offset by Nigeria’s industrial goods export to African countries. With the 100% elimination of tariff and 10% increase foreign capital investment, the export of industrial goods was only encouraged by an average of 0.7% over the period of 10 years. This result points to the fact that the AfCFTA will be trade-diverting as Nigeria’s imports from non-African countries will be substituted by imports from African countries. Hence, Nigeria will have to take anti-dumping measures more seriously during AfCTA ratifications and negotiations.

**Macroeconomic Impact of AfCFTA on Nigeria’s Industrial Sector**

1. **Investment Effect**

The most effective scenario that greatly supported investment drive across all the industrial subsector is the 4th simulation. With the linear elimination of tariff, increase in foreign investment and labour supply, the stock of investment of industrial subsectors significantly increase, ranging from the least 1.4% change in investment in Cement & Construction to 12.4% increase in investment of Water and Waste Management subsector (see figure 4). Other simulations show that there are winners as well as losers in terms of investment growth with the implementation of AfCFTA. The least effective scenario is reported when the government increase spending while also phasing out tariff (scenario 3). In such a case, AfCFTA is able to have a positive effect only on electricity and water & waste management subsectors. This is expected as the increase in government expenditure tend to erode private savings in the economy. Even when the government is not increasing spending, as the case of Scenarios 1 and 2 suggests, only textile and extractive industries are able to join the electricity and water management sectors on the trail of positive impact, albeit small marginal impact in the range of 0.13% to 0.01% increase. Without making a concerted effort to incentivise private capital inflows and boost domestic private sector investment in the Nigerian economy, the model results show that nearly 70% of the industrial subsectors will experience a decline in investment. An implied explanation for the expected decline in investment is that the choice of investment destinations will become more competitive with the AfCFTA implementation. This is because Nigerian companies will be able to produce in any African economy they perceive as having the best investment climate and trade their products freely in other African economies with the desired market.
2. Output Effects

With complete elimination of tariffs, only electricity, textile and extractive industries are positively impacted, with the textile industry recording the most impact. Phasing out tariff under the AfCFTA agreement will result in a 0.05% increase in textile industry output in the first period and then a 0.01% increase the second period. Even when the 90% reduction in tariff is negotiated and some strategic sectors are protected, the result will have a similar impact as in the case of the complete elimination of tariff. In both cases, the simulation results show that the implementation of AfCFTA will result to a decline in sectoral output of Chemical Products, Electrical, Motor Vehicles, Oil Refining, Water & Waste management, Wood Products, Cement & Construction and Food, Beverage & Tobacco sectors. The decline in sectoral GDP may be due to the decline in investment (see figure 5).

Source: NESG Research
However, the results show a significant improvement in the number of Nigerian industrial sectors that could expand output if the economy can attract more foreign investment and technical labour. By achieving 10% increase in foreign investment and labour supply, the impact of AfCFTA on the output of sectors such as electricity, textile, food & beverage, extractive, cement & construction, oil refining and wood products is positive, starting from the second phase of tariff elimination. The electricity industry, for instance, will expand out by 2.9% and 5.6% in in the first and second periods respectively.

**Import Effects**

The import effect is substantially different compared to other indicators. More industrial subsectors showed some improvements (See figure 6). Some sectors such as like the food, beverage and Food, Beverage & Tobacco, Chemical Products & electrical, Textile, Apparel & Footwear, Basic Metal & Motor Vehicles, Oil Refining and Extractive Industry all showed an increase in imports in all simulation scenarios.
With the elimination of tariff, AfCFTA has a negligible impact on industrial import, with 0.1% on the average over the 10 years. A similar effect is also observed when the government decides to exclude sensitive industries and allow 90% tariff reduction. The import effects, however, are quite substantial on the industrial sectors when there is 10% foreign investment is added to the country. Industrial sectors import transaction expanded more significantly to an average of 3% growth. The increase in import is expected following the elimination of tariff which leads to lower import prices.

**Export Effects**

In all the four scenarios, the results show that the increase in industrial export will be insufficient to compensate for the loss in import. The results show that the implementation AfCFTA will some broad positive effects on the industrial sectors, albeit not to the extent that the sectors lost in importation. If the gradual elimination of tariffs is applied, all the export of industrial subsectors captured in the analysis will increase by an average of 0.02% and 0.04% in both the first and second five-year implementation periods respectively. If foreign investment
inflows increase by 10%, the export of Basic Metal & Motor Vehicles and Chemical & Electrical sectors will decline. However, sectors such as Cement & Construction, Oil Refining, Wood & Wood Products, Food, Beverage & Tobacco, Textile, Apparel & Footwear and Extractive Industry will expand export more proportionally (See figure 7)

**Figure 7:** Export Effects of AfCFTA on Nigerian Industrial Sector

*Source: NESG Research*
Conclusion and Policy Implication

The promise of AfCFTA trade liberalisation agenda is far-reaching. At the current phase, it is an ambitious plan aimed at addressing the fragmentation of African markets at regional and continental levels. Such ambition for an African-wide market assumes that trade integration will create a conducive environment for efficiency gains from economies of scale and scope, increased competitiveness, better access to, and efficient use of resources including labour, capital and technologies. These are expected to culminate in greater diversification of African economies and promotion of continental value chains.

This report has attempted to quantify some of these proposals by evaluating the likely economic impact the AfCFTA would have on the Nigerian industrial sectors. The report used the NESG Computable General Equilibrium Model (NESG GEMOD) to measure the impact and provide some several insights. First, it is established in the results of various scenarios considered in the analysis that, the economic impact the Nigerian industrial sectors will derive from signing on to AfCFTA and eliminating tariff alone is very negligible. In effect, more of Nigerian industries would lose out in the trade integration agreement. However, the narrative changed when we assumed that the government implements pro-business and growth-enhancing policies that aid foreign investment and technical labour supply in addition to phasing out tariffs. From the result, the potential benefit derived by the industrial sectors from AfCFTA rose substantially across all economic indicators.

By implication, for the Nigerian industrial sectors to benefit from AfCFTA, it would require more than tariff reduction and/or elimination. It requires providing effective supportive economic structure to fairly partake in the gains. The benefits of AfCFTA will likely accrue unevenly among all participating countries. However, the larger portion of it will be captured by a few countries with stronger supply capacities and economic competitiveness. Also, there may be scope for further increases in the share of trade for countries that strengthen their value-added contents at all levels. Currently, Nigerian industrial sectors are not operating at the capacity (technical and volume) where they could leverage on the potential benefit of the AfCFTA to create more wealth for the economy.

To seize the opportunities offered by the integrated continental markets, - either AfCFTA or other agreements - there are various non-trade barriers inhibiting the productive capacity of the industrial sectors that must be addressed. There are issues which are specific to the difficult operating environment in Nigeria. These are long-standing structural economic problems that have subjected the economy to depending largely on importation for basic needs. To fully meet this challenge, the implementation of the AfCFTA must be supported by a cohesive industrial development framework including, rules of origin compatible with Nigerian productive capacity and the improvement of trade facilitation measures. More specifically, Nigeria needs to:
• **Addressing Structural failures and composition of Industrial output**
  To fully leverage the economic opportunities of the AfCFTA, Nigeria would need to adopt supportive policies to encourage structural transformation. In particular, Nigeria will need to critically examine the composition of its industrial output and identify areas where it can move up the value chains. Currently, primary commodities dominate Nigerian industrial outputs and the inter-industry linkages are very weak. As it is, primary commodities are exported to be processed further into intermediate industrial goods. On the other hand, the manufacturing sector depends largely on import for its raw materials. Such production arrangement is making Nigerian industries far less competitive. There is, therefore, the need for strategic actions to identify priority sectors in which industrial value chains can be maximised in the country. Policies to encourage structural transformation could include creating special intervention and investment promotion strategies to ensure a smooth reallocation of labour and capital to sectors that are more likely to expand industrial value chain development. It is only in this way that Nigeria's industrial sectors would be able to use the AfCFTA as a mechanism to claim its place in the global industrial production hub.

• **Tackling Infrastructural Constraints and creating an enabling business environment**
  The government needs to upscale its efforts in creating an enabling business environment. This is particularly relevant to the intraregional trade agreement. A lot of recommendations have been forwarded on the need to rejig customs and other administrative procedures at the Nigerian international borders. Other concerted efforts to address a broader array of barriers that hinder trade include infrastructure gaps. The reduction in ground transportation costs is especially critical to encouraging industrial production and value chain development. The quality of infrastructures such as power, seaports and airport needs to be addressed.

• **Dialogue with stakeholders will be a determinant factor of success**
  In setting priorities to support the industrial sector, policymakers in Nigeria must establish a close link with the private sector. Indeed, the government must be sure to listen to the needs and concerns of the private sector, across the industry value chains. Such dialogue will be crucial for gaining an understanding of constraints and competitiveness issues faced by businesses. It will also go a long way in helping the trade negotiators in understanding the economic sectors that will be most conducive to liberalisation, and which sectors would benefit from being excluded or gradually liberalised.