



NESG Policy Brief Series

Macroeconomic Effects of the African Continental Free Trade Area Agreement (AfCFTA) on the Nigerian Economy

Executive Summary

The framework agreement for the establishment of the AfCFTA was endorsed by 44 African countries in Kigali, Rwanda on 21 March, 2018. On July 8, 2019, Nigeria signed up to the AfCFTA framework Agreement. One main objective of the AfCFTA is to create a single continental market for goods and services across Africa. While stakeholders in Nigeria have expressed concerns that the agreement will have negative consequences on the economy, others have echoed optimism and highlighted potential benefits for Nigeria, if the agreement is well implemented. This policy brief examines the implications of the AfCFTA agreement on key macroeconomic indicators such as Gross Domestic Product (GDP), Government Revenue, Private Investment and Inflation in Nigeria. This brief also examined how the Nigerian government can maximise the benefits of the agreement and minimise associated costs. In this brief, four scenarios were created and the results for each scenario were compared with a baseline which showed the direction of a specific variable if Nigeria had not signed the AfCFTA. When the results of each scenario were compared with the baseline (if Nigeria had not signed the AfCFTA), the outcomes were mixed and the magnitudes of the differences were mostly negligible across the four scenarios established. In essence, removal of tariffs under the AfCFTA arrangement has no major consequence on key macroeconomic indicators in Nigeria. This policy brief provided critical recommendations such as the need for Nigeria to develop a comprehensive and up-to-date trade policy; the need for the Nigerian government to address specific constraints that limit competitiveness of Nigerian exports; the need for involvement of key stakeholders including the private sector during the AfCFTA negotiation process; as well as the creation of strict and enforceable mechanism of the rules of origin within the trade agreement. Lastly, the brief recommended that the Nigerian government must improve border scrutiny and security to prevent dumping and abuse of the rules of origin by traders.

Introduction

The African Continental Free Trade Area (AfCFTA) represents one of the most ambitious attempts of the African Union Heads of States and Governments to economically unite Africans and economies. It also represents a bold attempt by the African Union Heads of States and Governments to provide or at the least, experiment with an “African solution” to “an African” problem. The AfCFTA is the first step in the implementation of African Union (AU) Agenda 2063: the “Vision” for an integrated, prosperous and peaceful Africa. The proponents of the Continental Free Trade Area project are deeply convinced of the potential of the AfCFTA to broaden and strengthen the scope for intra-African trade as well as improve the well-being of African people.

The antagonists of continental free trade area in Africa, unfortunately, do not agree with the proponents. The antagonists believe the AfCFTA will be damaging to participating countries’ economies. This group specifically argue that by eliminating tariffs and non-tariffs barriers, the AfCFTA will severely decrease government revenue, thereby worsen the fiscal stance of many African countries. They also argue that it will exacerbate firm losses and that the exposure of domestic firms to foreign competition will reduce demand and profitability, which in turn will have an adverse effect on productivity.

Given the huge market potential in Africa, there is a tremendous possibility that AfCFTA will become an African success story. However, the amount of success that is achievable in this “African Project” will depend to a large extent on the quality of preparation that is infused to the negotiation and implementation of the AfCFTA agreement by African countries.

Despite Nigeria being the largest economy in the continent with a GDP of US\$420 billion in 2018, several stakeholders in the country have argued that the removal of tariff and other non-trade barriers under the AfCFTA arrangement would adversely affect the country’s economic output, government revenue and the performance of key sectors. Some of these concerns are highlighted below:

- The Nigerian economy is largely reliant on crude oil for foreign exchange earnings and revenue; and relies on imports at the expense of local production. This makes the economy fragile and susceptible to external shocks.
- High production cost occasioned by poor power supply, infrastructure deficits, high interest rates and other factors limit competitiveness of businesses and, of course, exports.
- The Nigerian economy is still on the recovery path from the economic recession in 2016. GDP growth was 1.9% in 2018, far below its potential.

- Poor state of the manufacturing sector which accounts for 9% of GDP and 3.4% of total exports; among other factors.

Although Nigeria signed the AfCFTA framework agreement in July 2019, the initial reluctance of the Nigerian Government to sign the agreement was borne out of the above concerns of different stakeholders regarding the possible harmful consequences of joining the AfCFTA. Now that Nigeria has opted in on the agreement, some key questions remain: What are the implications of the AfCFTA on key economic aggregates such as GDP, Government Revenue, etc.? What should be Nigeria's offensive and defensive interests during the negotiations? How can Nigeria reposition to ensure it reaps the gains of the AfCFTA?

The aim of this policy brief is to examine the implications of the AfCFTA agreement on key macroeconomic indicators in Nigeria. This brief also examines how the Nigerian government can maximise the benefits of the agreement and minimise associated costs. Major macro aggregates examined are GDP, Government Revenue, Private Investment and Inflation.

Methodology

To achieve the aim of this brief, we adopt the NESG Computable General Equilibrium (CGE) model which was specifically developed to estimate the impact of the AfCFTA agreement on the macro economy, economic agents such as businesses, rich and poor households and sectoral outputs, etc.

The model has eight blocks: production, income and savings, demand, international trade, prices, equilibrium, dynamic equations, and other variables blocks. The model does not involve any intertemporal or truly dynamic optimization behavioural assumption but rather recursive optimization, characterized by a sequence of temporary equilibria.

Scenarios Setting

To better examine the impact of the AfCFTA on the Nigerian economy, we provided, first, a baseline, which shows the movement of the interested variable if Nigeria had not signed the AfCFTA. Secondly, we developed four different scenarios, detailing several assumptions relating to the gradual removal of tariffs, introduction of special products, increase in government investment in key sectors and inflow of Foreign Direct Investment (FDI) and labour into strategic sectors.

	Scenarios	Assumption	Period 1 0 - 5 years	Period 2 6 - 10 years
Nigeria does not sign the AfCFTA	Baseline	This shows the movement of economic variables if the government had not signed the AfCFTA		
Nigeria signs the AfCFTA and the agreement comes into force	Scenario 1: Full Liberalisation	The Nigerian government imposes a linear cut in tariff on all imported products in 10 years	Tariff removal for 50% of imported products	Tariff removal for the remaining 50% of imported products
	Scenario 2: Partial Liberalisation	The Nigerian government imposes a linear cut in tariff on 90% of imported products The remaining 10% imported products are protected	Tariff removal for 45% of imported products	Tariff removal for 45% of imported products
	Scenario 3: Full Liberalisation with increase in government spending	The Nigerian government imposes a linear cut in tariff on all imported products in 10 years 10% increase in government investment	Tariff removal for 50% of imported products and 10% increase in government investment	Tariff removal for 50% of imported products and 10% increase in government investment
	Scenario 4: Full Liberalisation with increase in foreign capital inflow	The Nigerian government imposes a linear cut in tariff on all imported products in 10 years 5% increase in labour supply 5% increase in foreign capital inflow	Tariff removal for 50% of imported products; 5% increase in labour supply; 5% increase in foreign capital inflow	Tariff removal for 50% of imported products; 5% increase in labour supply; 5% increase in foreign capital inflow

In **Scenario 1**, it is assumed that at the end of the 10 years of the AfCFTA, the Nigerian government would have lifted tariffs on all imported items produced in Africa. However, the tariff removal is done in two phases: removal of tariffs on half of all imported items within the first five years (period 1) and removal of tariffs on the remaining imported items in the next five years (period 2).

Scenario 2 assumes the tariffs are removed on 45% of all imported items within the first five years and 45% within the next five years. The remaining 10% of imported products are exempted from tariffs removal, as the Nigerian government plans to protect “special” or infant industries from foreign competition in the form of imported goods.

Scenario 3 holds the assumption of Scenario 1, but introduces a 10% increase in government investment/spending on critical areas of the economy such as infrastructure, education, health, security etc. It is believed that such increase in investment would ameliorate the conditions of local businesses and further drive down cost of production to make their products competitive.

Scenario 4 holds the assumption of Scenario 1, but assumes an increase in labour supply particularly foreign workers as well as an increase in foreign capital inflow into strategic sectors of the economy. This assumption is based on the expectation that as tariffs are removed, foreign and local investors seek to maximise the opportunities of cheap Nigerian exports to other African countries and therefore make significant investment in the productive sectors of the economy.

The rest of this Policy Brief examines the performance of agricultural output, exports and imports under each scenario.

Results/Findings

The results for each scenario are compared with baseline data, which captures the movement of a particular variable if the AfCFTA does not come into effect.

Effect on GDP

The results for the different scenarios are mixed and, in some cases, similar across the scenarios. In all of the analyses, we compare GDP value if Nigeria had not signed the AfCFTA (Baseline) with projected GDP for each scenario.

When compared with the baseline GDP (if Nigeria had not signed), GDP was lower for scenario 1 and 2 in the 10-year period. Specifically, the difference between GDP in scenario 1 and the baseline GDP was minimal, though negative. GDP declined by an average of 0.02% in the first five years and 0.04% in the next five years. This suggests that GDP would have been 0.02% and 0.04% higher in period 1 and 2 respectively, if Nigeria had not signed the AfCFTA agreement. For scenario 2, GDP averaged N74.1 trillion within the first five years of the AfCFTA and N85.9 trillion in the next five years. This represents a decline of 0.01% and 0.04% from the respective baseline GDP in both periods. In other words, a linear cut in tariff and the introduction of 10% special products resulted in a lower GDP compared to if Nigeria had not signed.

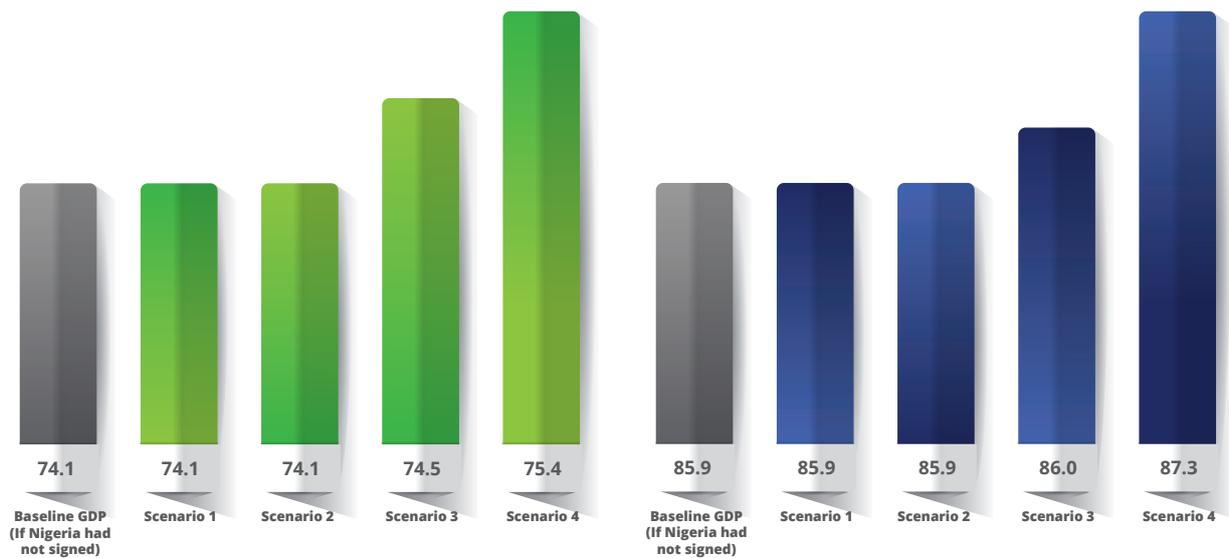


Figure 1: Average GDP from Year 1 to Year 5 (Trillion Naira)

Figure 2: Average GDP from Year 6 to Year 10 (Trillion Naira)

For scenario 3 and 4, GDP was higher than the baseline GDP in the 10-year period, except for Year 9 and 10 in scenario 3. In scenario 3, which assumes a 10% increase in government spending to address constraints of local producers, average GDP in period 1 was higher than the baseline GDP by 0.6%. In period 2, it was 0.07% higher than the baseline GDP. The positive results of scenario 3 suggest the significance government spending to provide basic infrastructure and support local industries, which ultimately could reduce production cost and make Nigerian products competitive in the export market.

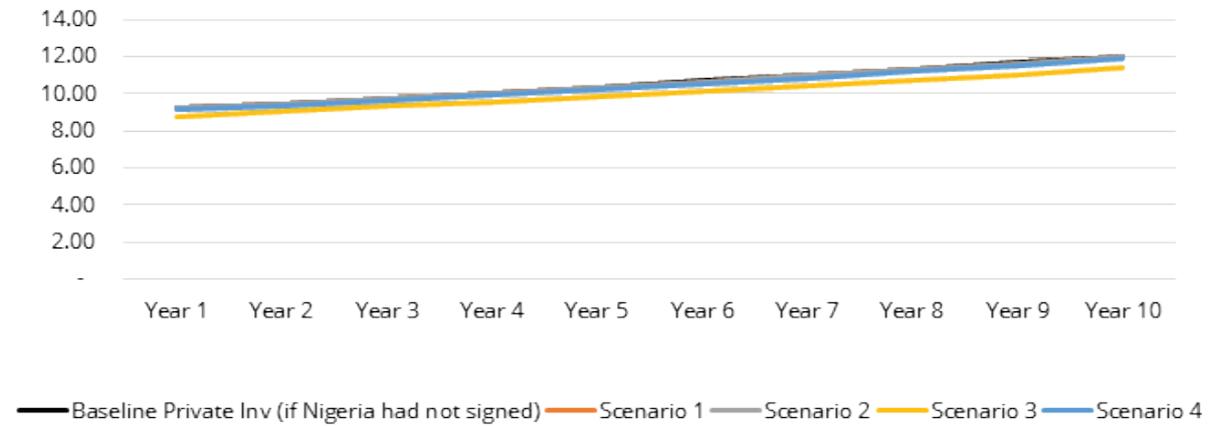
Scenario 4 showcased the largest GDP growth, which averaged 1.8% and 1.6% in the two periods, respectively, when compared with baseline GDP. The better outcome of scenario 4 in relation to other scenarios emphasises the importance of capital investments into strategic sectors of the economy, to take advantage of the liberalised markets under the AfCFTA arrangement.

Summarily, when GDP for each scenario is compared with 'GDP if Nigeria had not signed the AfCFTA', the outcomes of scenario 1 and 2 fell short marginally, while scenario 3 and 4 fared better on the average.

Effect on Private Investment

When compared with baseline data (if Nigeria had not signed), Private Investment declined marginally across all scenarios. In relation to other scenarios, the decline in scenario 3 (when government increases spending by 10%) was significant in period 1 and 2. This is expected as the increase in government expenditure reduces the aggregate savings in the economy. Interestingly, even when foreign investment inflows and increase labour supply are expected, total investment still declined in both periods of the AfCFTA implementation.

Figure 3: Trend of Private Investment from Year 1 to Year 10 (Trillion Naira)



Note: Baseline Private Investment, Scenario 1, 2 and 4 exhibited similar trends. Differences between these scenarios were minimal.

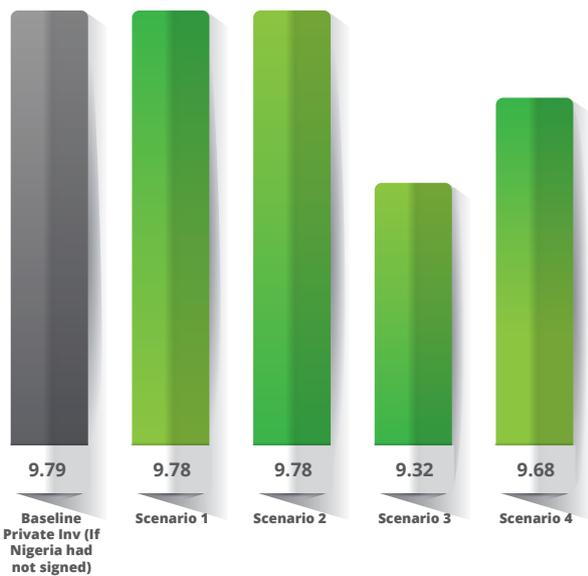


Figure 4: Average Private Investment from Year 1 to Year 5 (Trillion Naira)

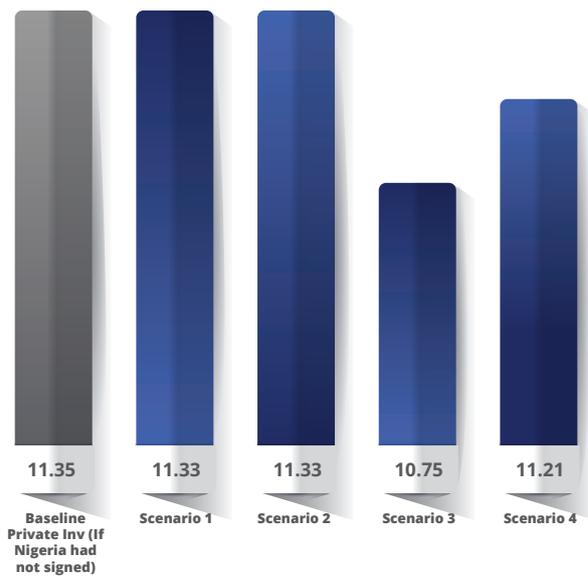


Figure 5: Average Private Investment from Year 6 to Year 10 (Trillion Naira)

Effect on Government Revenue

The effects of signing the AfCFTA on government revenue are largely negligible across all scenarios, except in scenario 4 where average government revenue increased from the baseline by 1.8% and 1.5% in period 1 and 2 respectively. The insignificant impact on government revenue is as a result of Nigeria’s low trade with other African countries. According to the National Bureau of Statistics, Nigeria’s imports from other African Countries accounted for only 3.5% of total imports in 2018. Also, the share of tariffs income in total government revenue is insignificant. Therefore, removal of tariffs on imports from other African countries was insignificant in the performance of government revenue.



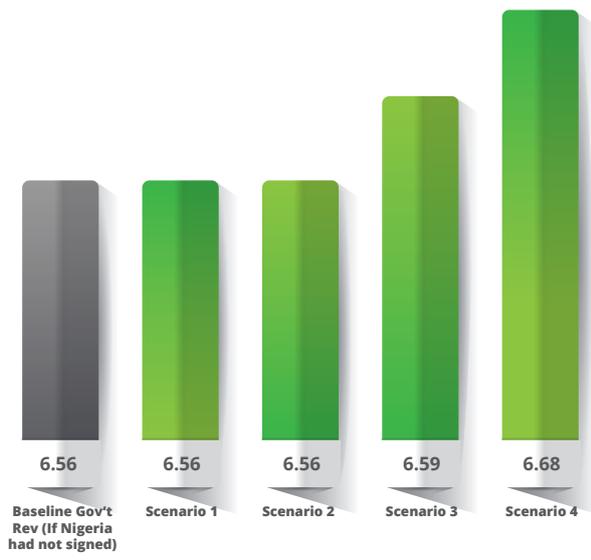


Figure 6: Average Government Revenue from Year 1 to Year 5 (Trillion Naira)

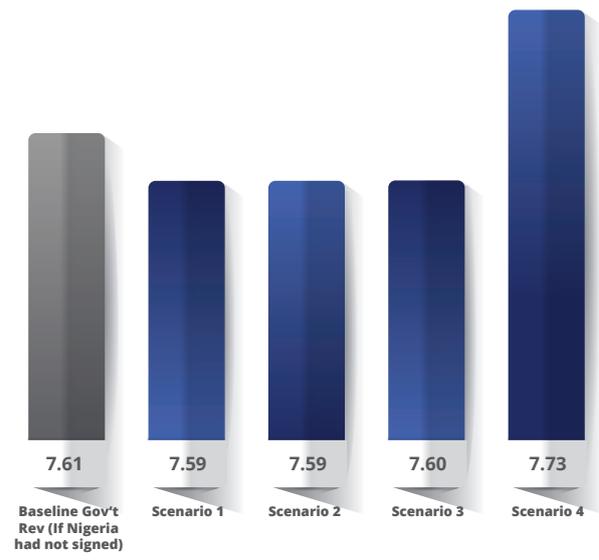
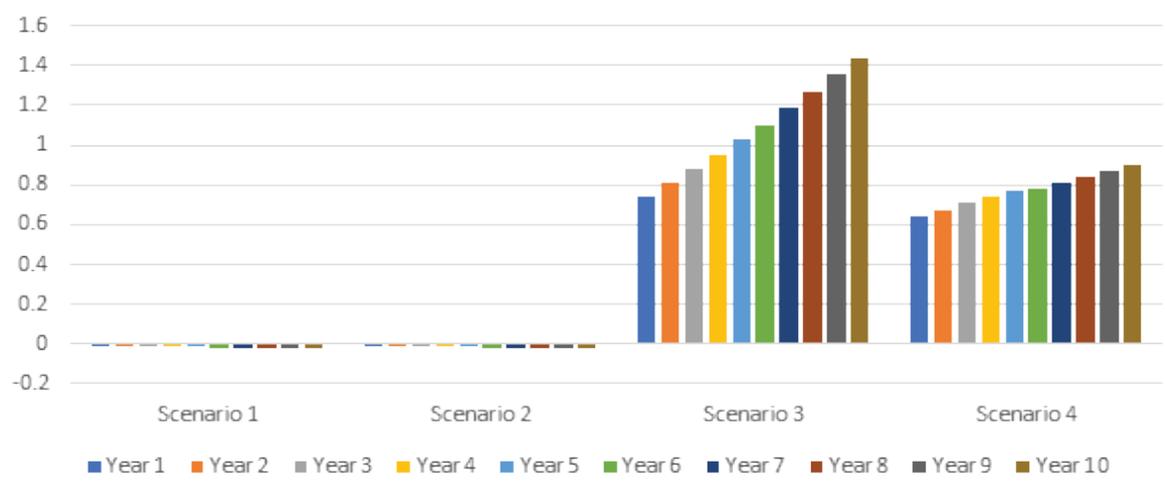


Figure 7: Average Government Revenue from Year 6 to Year 10 (Trillion Naira)

Effect on Prices

Tariff cuts are in general expected to exert downward pressure on prices. These will include consumer price, producer price, price of intermediate consumption, and factor prices. This reduction in prices can then be converted into welfare gains in the economy. As shown in Figure 8, consumer prices will be in decline throughout the AfCFTA ten-year implementation period in scenario 1 and 2. What this means is that consumers of goods and services are expected to pay less for the same quantity of goods and services from other African countries. However, consumer prices will increase in general if the trade liberalization strategy applied will include ten percent exogenous increase in government expenditure or some five percent exogenous increase in labour supply and foreign capital inflow. This way, the welfare gains that are observable in the first two scenarios are easily offset by the injection of resources into the economy at least, throughout the AfCFTA implementation period.

Figure 8: Price Effect (%)



Conclusion and Recommendations

This policy brief examined the impact of Nigeria's signing of the AfCFTA on key macroeconomic indicators. When the results of each scenario were compared with the baseline data (if Nigeria had not signed the AfCFTA), the magnitudes of the differences were mostly negligible across the four scenarios established in this report. Therefore, we conclude that on the aggregate level, the removal of tariffs will have no significant positive or negative impact on macroeconomic aggregates during the 10-year period of the AfCFTA. In other words, Nigeria's adoption and implementation of the AfCFTA agreement, will exhibit no major consequence on the macro economy.

One reason for the insignificant difference is the low level of trade between Nigerian and other African countries. Majority of Nigeria's imports come from outside the African continent. As at 2018, only 3.5% of Nigeria's imports comes from Africa, with a significant share of these goods produced outside the continent. Because only goods produced in Africa qualify for the AfCFTA under the rules of origin provision, tariffs removal in Nigeria will be applied to only about 2% of the country's total import value, although this percentage is expected to increase in coming years.

Another factor is the weak contribution of government earnings from tariff on imports from African countries to total government revenue. We estimate that revenue from tariffs on imports from Africa as a share of total government revenue stood at 5% in 2017. These therefore suggest the weak link between the removal of tariffs in Nigeria within the AfCFTA arrangement and key macroeconomic aggregates such as GDP, Investment, Government Revenue etc, as shown in the simulation results.

Nigeria exports more than it imports from other African countries. No doubt, the AfCFTA provides an opportunity for Nigeria to further grow its export to other African countries, which stood at 13% of total exports in 2018. For Nigeria to leverage and maximise the benefits of the AfCFTA, the following recommendations are crucial:

- ***Nigeria needs to develop and publish a comprehensive, up-to-date Trade Policy Document.*** The current Trade Policy was last revised in 2012 and does not take into consideration current realities and the country's aspiration in relation to trade. While the National Office for Trade Negotiation (NOTN) has begun developing the country's trade policy, efforts to complete the process must be intensified. Furthermore, the NOTN and the Ministry of Industry, Trade and Investment must engage critical stakeholders in the review and validation process to ensure that diverse considerations are reflected and that the document represents the strategic interest of Nigeria even as the AfCFTA negotiations begin.

- Nigeria's Trade Policy must reveal clearly, areas of Nigeria's competitive advantages, areas of opportunity and where Nigeria intends to build competitive advantages in relation to trade and how Nigeria intends to leverage on the AfCFTA and other trade deals/agreements.*** For instance, one area of opportunity as revealed in the conclusion of this brief is to export manufactured goods (which account for a larger share of African imports from other continents) to other African countries. With the gradual removal of tariffs on selected goods produced within Africa, Nigerian exports could become more competitive relative to African countries' imports from other continents. At the moment, manufactured goods accounted for just 3.4% of total Exports in Nigeria, one of the lowest among peer countries (Malaysia- 68%, Indonesia- 44% and South Africa- 47%). The government of Nigeria therefore must focus on improving the state of the manufacturing sector and ensure Nigeria capitalizes on the opportunities of the agreement. Similarly, 88% of Nigeria's exports to Africa is crude oil and this therefore suggests enormous opportunity in improving non-oil export to other countries in the continent.
- One major risk for Nigeria when the AfCFTA comes into force is the abuse of rules of origin, a situation where traders or producers disguise that goods are produced within Africa so they can qualify for tariff-free treatment.*** To address this risk, there is need for strict and enforceable mechanism within the trade agreement. Nigeria must also improve border scrutiny and security to prevent dumping.
- Nigerian government must intensify the implementation of regulatory reforms to remove constraints facing the growth of exports in Nigeria.*** For instance, there are over 26 checkpoints and stoppages by regulatory agencies along the Seme border route. The unnecessary checkpoints result in delays and unwarranted charges are levied on exporters, thereby making their products costlier and uncompetitive. The government therefore must urgently reduce the number of checkpoints along all border routes across the country. Other measures to stimulate non-oil exports include:

 - Develop seaports in the South South and South East to reduce congestion of the Lagos ports
 - Monitor and enforce standards and certification of made in Nigeria products
 - Address Infrastructure and electricity constraints
 - Automate and simplify the export process and procedures and create an export single window in Nigeria.

- ***The Federal Government of Nigeria must constantly involve and engage the private sector before, during and after the AfCFTA negotiation process***
The private sector, academia and business member organisations must be engaged and fully carried along in the negotiation process to ensure their views and concerns are considered and addressed. The negotiation process must be all-inclusive as this is crucial in understanding the technicalities involved and negotiating for a better deal for the country.

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About NESG

The NESG is an independent, non-partisan, non-sectarian organization, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving Nigeria's economic policies, institutions, and management.

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