Policy Brief

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Manufacturing Sector and Nigeria's Economic Growth Pattern:

Redesigning Policy Intervention for Inclusive Growth

The Nigerian Economic Summit Group

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Executive Summary

Across many fast developing countries, the manufacturing sector is the backbone of industrialisation and developing this sector is important in moving a step closer towards inclusive growth. In addition to reducing demand pressures on foreign exchange, a strong manufacturing sector is strategic in ensuring value addition, job creation and export or consumption-led industrial growth, all of which are crucial in reducing poverty. Although Nigeria's manufacturing sector has experienced growth in output in the last 10 years prior to the recession of 2016, its contribution to GDP at 9% and meagre contribution to employment calls for concern. Despite government intervention, the sector is bedevilled with several structural challenges ranging from multiple taxation to infrastructure deficit, power supply shortages, high reliance on imported manufactured products and the absence of an up-to-date coordinated policy framework, which charts a clear path for the sector. In the light of the foregoing, this Policy Brief examines the state of Nigeria's manufacturing sector and proposes policy interventions such as review and prioritize implementation of the Nigerian Industrial Revolution Plan (NIRP); pursue diversification within manufacturing; ensure inter-sectoral policy coordination and strong backward and forward linkages and embark on targeted infrastructure development.

Introduction

Since the year 2000, Nigeria's economic growth has not delivered significant poverty and unemployment reduction. While GDP growth increased from 6.7% in 2006 to 9.5% in 2010, unemployment rate moved from 12.3% to 21.4% in the same period. By the year 2015 prior to the economic recession, unemployment and underemployment rate had reached a peak of 29%. That same year, life expectancy was 53.1, lower than those of Brazil (74.7) and Ghana (61.5). In addition, 46% of the country's population lived below the national poverty line, according to the World Bank's Human Development Indicators (HDI) Report.

Failure to achieve inclusiveness is largely as a result of the fact that economic growth has not been broad-based. A major reason why GDP growth has not translated into improved living standards can be found in the pattern and dynamics of economic growth over the last two decades. Nigeria's economic growth pattern can be simply explained by the phrase "service-led growth." From 2000 to 2015, the services sector contributed 61% to real GDP growth. This growth was led by key subsectors such as trade, telecoms, real estate and financial services. The productive sectors such as manufacturing, construction and agro-processing only accounted for 15% of overall growth during the same period.

The growing services sector and rising unemployment rate suggests that value addition in the service sector is low, relative to the productive sector. This, therefore, brings to the fore three key policy considerations:

First, to achieve economic growth that delivers unemployment and poverty reduction, efforts are required to alter the pattern of GDP growth by developing the productive sectors. Nigeria needs to implement reforms that will open up and attract investments into key subsectors within the manufacturing and agro-processing sector, thus, creating opportunities along value chains.

Macroeconomic stability, good governance and provision of infrastructure are supporting factors that will improve productivity and output across sectors.

Second, to address poverty and unemployment, GDP growth must be led by the productive sectors. The growth pattern in 2018 and beyond must be different from that of the pre-recession era. Inclusive growth embraces the need for a strong industry-led economy. For instance, industrial sectors such as manufacturing, agro-processing, and construction should be the engine of economic transformation. Rapid expansion of the manufacturing and agro-processing sectors will lead to massive job creation, diversification of export earnings and reduction in importation of foods and other items that can easily be produced locally.

Third, growth within productive sectors must be widespread and include major subsectors. This emphasises the need for diversification within manufacturing, agriculture, construction and other key sectors. In manufacturing, only 3 subsectors (food & beverage, cement and textile) account for 77% of manufacturing output. Similarly, in agriculture, crop production accounts for 91% of agricultural output, leaving the remaining 9% for fishery, forestry and livestock. To move a step closer to achieving inclusiveness, deliberate policy interventions are required to open up these subsectors.

This brief aims to review the manufacturing sector by identifying key structural bottlenecks, highlighting their implications, explore recent government interventions and proffer workable policy interventions.

X-raying the Manufacturing Sector

Nigeria's manufacturing sector has largely been left out of the growth process, given its low contribution to GDP and employment. Over the years, Nigeria's high import of manufactured products and weak export of processed goods are evidences of the inherent weakness of the sector. Meanwhile, the weak performance of the manufacturing sector is also reflected in the low share of non-oil exports to total exports earnings as well as the high share of manufactured goods in total imports. Data from the National Bureau of Statistics (NBS) show that non-oil exports as a percentage of total exports averaged 7% in the past three years, while the manufactured and processed products as a share of total imports increased from 31% in 2014 to 38% in 2017.

Prior to 2015, Nigeria's manufacturing sector experienced rapid growth for over a decade led by few sub-sectors. Between 2005 and 2014, for instance, the sector grew by an annual average of 12%, fuelled largely by increasing consumer demand and the GDP rebasing exercise, which expanded the scope of manufacturing to include 13 subsectors. Growth in the sector was led by only few sub-sectors such as Cement and Food, Beverages & Tobacco. Despite the sector's rapid expansion, increases in non-oil/manufactured goods export were only marginal even as Nigeria experienced sharp growth in imported food items and manufactured products. As a matter of fact, imports remained the dominant source of inputs into food, beverages and tobacco in Nigeria, accounting for more than 70% of all raw materials (McCulloch, Balchin, Mendez-Parra and Onyeka, 2017).

The end of the oil boom era ushered a "new normal" situation for the country where foreign exchange rationing and exchange rate depreciation was prevalent. The exchange rate crisis that followed in 2016 showed clearly the inherent weakness of Nigeria's manufacturing sector, which also suffered from foreign exchange scarcity that resulted in declining outputs, higher operating costs and input shortages. As a result, the manufacturing sector experienced contraction, with an annual growth rate of -4.3% in 2016.

But beyond foreign exchange, structural challenges still affect manufacturing output. Foreign exchange stability occasioned by increased crude oil price in 2017 was largely responsible for the positive growth in manufacturing output in the first half of the year. However, the decline of manufacturing output in the third quarter of the year amidst exchange rate stability revealed that the challenges facing the sector are not limited to the unavailability of foreign exchange. Despite achieving stability in exchange rate in 2017 and a growing external reserve, which stood at US$32.5 billion at the end of the third quarter, manufacturing output declined by 0.21% in 2017 and its share in GDP remained at 9%. The decline in manufacturing output was led by Oil Refining (-28%), Motor Vehicle and Assembly (-22%), Other manufacturing (-7%) and Cement (-2%). Key issues relating to infrastructure, power shortages, multiple taxes and the influx of imported goods continue to limit growth of the sector.

The sector is highly concentrated and less competitive. In addition to the declining output of the sector in recent years, the structure of Nigeria's manufacturing sector is weak as revealed by the high Herfindahl-Hirschman Index (HHI) of 2,646. This implies that the sector is highly concentrated and dominated by few subsectors, therefore confirming that the sector is less competitive. As the manufacturing GDP data shows, only three out of thirteen sub-sectors contribute 76% to its overall output. These three sectors include Food, Beverage & Tobacco (45%), Textile, Apparel and Footwear (23%) and Cement (9%). The remaining 26% is shared among ten major sectors including "other manufacturing".

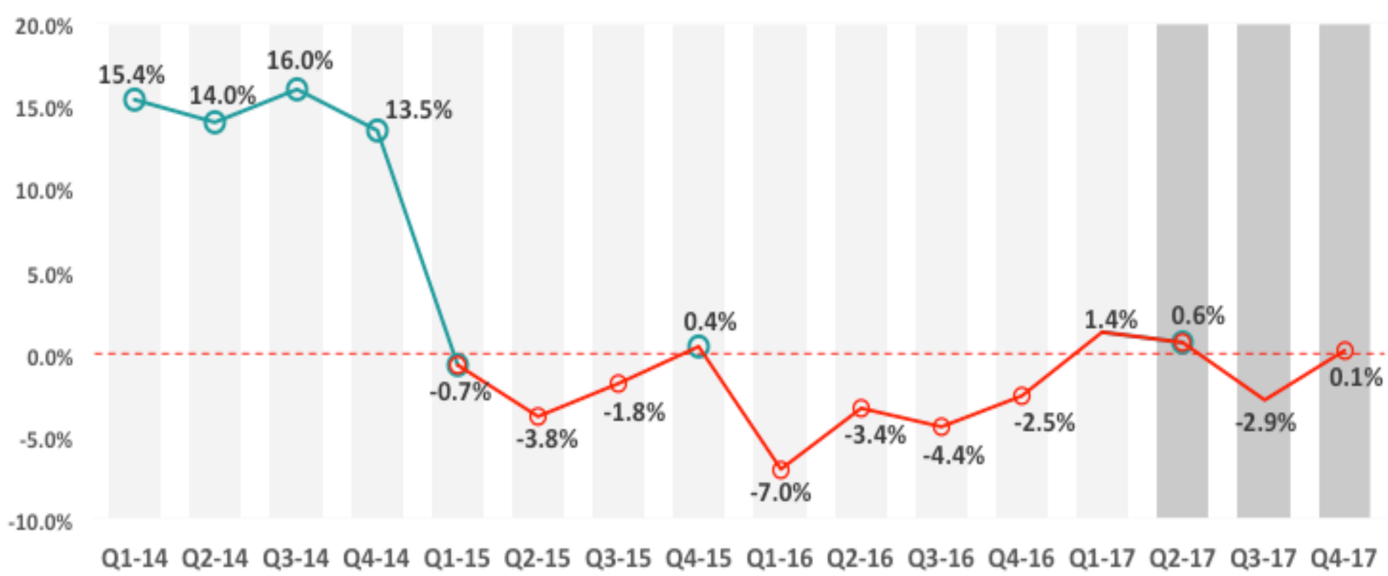

Figure 1: Nigeria's Manufacturing GDP Growth
Source: National Bureau of Statistics and NESG Research

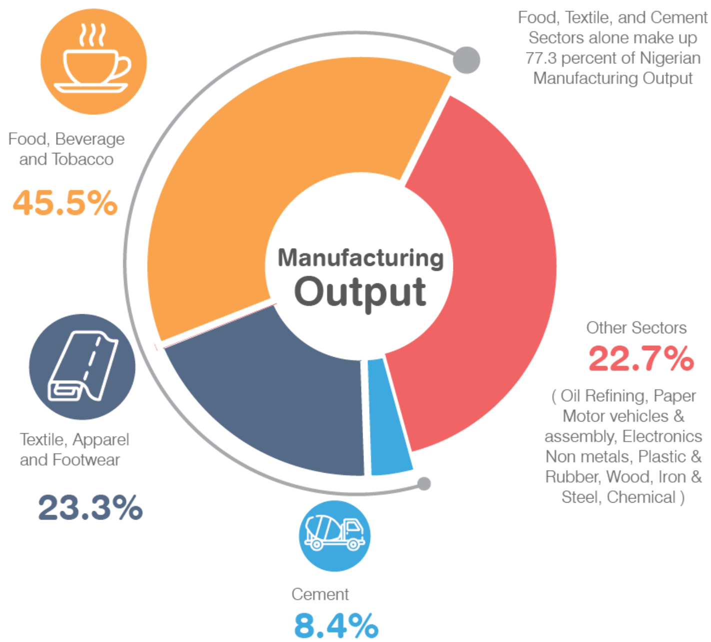

Figure 2: Share of Nigeria's Manufacturing GDP in 2017
Source: National Bureau of Statistics and NESG Research

Backward Integration remains a challenge for most manufacturing firms in Nigeria. A host of supply issues affect the quality, quantity and availability of local inputs, thereby further dis-incentivising downstream processors from procuring local inputs and establishing backward linkages in Nigeria. These include low productivity in manufacturing, lack of local capacity (in many different areas), limited options for sourcing locally, limited access to technology and a lack of technological know-how, poor infrastructure, fragmented local supplier bases and poor coordination between suppliers and downstream purchasers, financial constraints, inconsistent policies and poor implementation of existing policies (McCulloch, Balchin, Mendez-Parra and Onyeka, 2017).

A Weak Manufacturing Sector has Several Implications for the Economy

The high concentration of the sector underscores the urgent need for the Nigerian government to pursue widespread growth of the subsectors within manufacturing given their strategic importance in job creation and import substitution. With Nigeria's strategic role in West Africa and its abundant mineral resources, the country cannot afford to have a weak manufacturing sector. The neglect of this sector comes at a social and economic cost, with the following implications:

- Despite positive GDP growth, the Nigerian economy is highly vulnerable to oil price shocks. Nigeria's GDP growth or decline is fuelled by the oil sector. In 2017 for instance, oil sector GDP growth of 5% was enough to pull the economy out of recession. With a weak manufacturing sector, a fall in oil price and output will have negative effects on GDP growth and external reserves and result in foreign exchange challenges.
- Importation of consumer goods is on the rise. Imported goods and by-products increased by 43% to N3.5 trillion in 2017Q2. With declining manufacturing output, increase in importation of consumer goods is inevitable. This will lead to increased demand for foreign exchange and exert pressure on the external reserves if oil price declines.

The decline in manufacturing dampens the prospect of improving the already poor contribution of non-oil exports to total exports and foreign exchange earnings.

Recent Government Intervention in Manufacturing Sector

Successive administrations have adopted several interventions to improve the performance of the sector. The government's policy agenda emphasises the importance of developing value chain linkages with the country's agriculture sector. Some of these programs and interventions include:

Agricultural Transformation Agenda (ATA): The ATA targeted the use of agricultural inputs to feed industry, focusing on food processing (beverages, packaged food products), sugar, palm oil processing, cocoa processing, leather and leather products, rubber products, textiles and garments. Under the ATA, Nigeria's food imports declined by over US$5 billion.

Agricultural Promotion Policy (2016-2020): This plan builds on the successes of the ATA. It aims to close demand-supply gaps in crop and livestock production among other things.

Nigerian Industrial Revolution Plan (NIRP): Developed in 2014, the NIRP looks to maximise the benefits from agricultural resources, including by building an end-to-end integrated agro-industrial value chain (Government of Nigeria, 2014). The plan targets light manufacturing, agro-processing and other key sectors.

Interventions such as Anchor Borrowers' Program, Growth Enhancement Support Schemes (GESS), Agriculture Credit Guarantee Scheme Fund, Nigeria Sugar Masterplan, Backward Integration Policy in Cement, the Economic Recovery & Growth Plan among others.

Ease of Doing Business Reforms: The Presidential Enabling Business Environment Council implemented series of reforms including revising the timeline for company registration, digitizing business incorporation process and simplified the Visa-On-Arrival process, among other reforms.

Lingering Challenges facing the sector

As a result of some of these interventions and reforms, Nigeria was able to achieve notable successes in Cement, Sugar, Rice production and other sectors. Despite these successes, some concerns relating to why government policies have not achieved the desired results across major manufacturing subsectors include:

Proliferation of imported consumer goods. Nigeria currently spends about N2.3 trillion annually importing food and manufactured items (excluding refined crude). The influx of manufactured items into the Nigerian market affects the growth of local manufacturing firms, many of which cannot compete favourably with these imported items.

Regulatory bottlenecks and multiple taxation are frequent challenges in the sector. We note efforts of the Presidential Enabling Business Environment Council, which already yielded positive impacts on the business environment as confirmed by Nigeria's recent improvement to 145th on the World Bank Ease of Doing Business Ranking. We believe these efforts should be continued and extended to other states to ensure appreciable progress across the country.

Overtime, the above challenges have resulted in high operating costs in the sector and have led to the closure of several manufacturing outfits. Between 2015 and 2016, the Manufacturers Association of Nigeria (MAN) estimated that over 50 manufacturing firms shut down operations due to high operational cost arising from poor power supply, foreign exchange scarcity, infrastructure deficit, high transport costs, among others. These factors also affect capacity utilization and profitability of firms operating in the sector.

Inability of the government to define clear vision and mobilize investments for strategic subsectors in the manufacturing industry. Some of these sectors include leather, steel and metals, paper, wood and to some extent petrochemicals.

Required Policy Intervention

In the light of the above, the NESG proposes the following policy interventions for the manufacturing sector.

Review and prioritize implementation of the Nigerian Industrial Revolution Plan (NIRP), which outlines the roadmap for developing the manufacturing and agro-processing sector. Communication of the plan to both domestic and foreign stakeholders is crucial in mobilizing investments into strategic sectors of the economy. Investors need assurances and the NIRP coupled with the demonstration of commitment to implement the plan would be useful to guarantee investors' confidence. The plan must also be in sync with Nigeria's trade policies.

Pursue diversification within manufacturing. Conscious efforts are required to increase the contribution of manufacturing to GDP from the current 8.8% and ensure diversification within the sector by growing output of the thirteen major subsectors. Production incentives are required for sectors such as chemical & pharmaceutical products, plastics & rubber products, wood & wood products and electronics. These sectors should be nurtured and exempted from undue taxes and levies in the short term. In addition, incentives such as tax holidays should be encouraged to attract investments into these subsectors.

Ensure targeted infrastructure development. Developing critical infrastructure that has direct linkage with manufacturing should be prioritized given their strategic importance. Such infrastructure includes port access road such as the Apapa-Oshodi Expressway; Enugu- Onitsha Expressway, Warri-Port-Harcourt Expressway, Nsukka-Makurdi Expressway, Lagos-Badagry Expressway; Kano-Katsina Highway among others.

Ensure inter-sectoral policy coordination and strong backward and forward linkages. The strengthening of backward linkages is often seen within the context of a single sector. However, it often requires coordination across policies in different sectors, because the input for one sector can come from another. For example, the waste products from backward-integrated industries, for example crushed sugar cane, palm sheath, used tyres, can be used as fuel for local renewable energy generation. Policy coordination across different sectors that are linked will therefore prevent wastage and enhance value chain development.

Consider alternative funding and operational model for the refineries. On a sub-sectoral level, oil refining, which contracted by 28% in 2017, has been a major subsector that has limited the growth of manufacturing output since the last decade. Frequent shut down of government-managed refineries either as a result of turnaround maintenance or due to increasing operational costs largely affect oil-refining output. In July 2017 for instance, the NNPC monthly operational report showed that ₦11.87 billion was lost due to downtime and "unimpressive performance of the refineries". We therefore urge the NNPC to consider several models of operating the Nation's three refineries, so as to ensure that they are running optimally and meeting the nation's energy needs. Public-Private Partnership (PPP) frameworks that have proven effective in crude oil exploration should be adopted in managing the refineries.

In the past few months, there has been traction in the oil refining space with the development of modular refineries, which are crucial to expand the subsector, reduce importation of petroleum products and create jobs. We urge the government to hasten the completion of these projects by incentivising their developers.

Implement import substitution policies in areas of comparative advantages. Nigeria has comparative advantage in several industries such as leather, food and beverages, petrochemicals, etc. Protectionist policies, complemented by industrialization reforms within these sectors to attract both local and foreign investments are required. The government must ensure that protectionist policies are temporary, performance-based and phased out when local industries achieve the necessary levels of competitiveness. This will ensure local industries are cost effective, technology-driven and price conscious. This will also reduce elements of rent seeking from local firms that dominate their sectors.

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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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