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THE NIGERIAN ECONOMIC SUMMIT GROUP

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MARKET REFORMS FOR SHARED PROSPERITY IN NIGERIA

Lesson from China Growth Miracle

APRIL 2023

In February 2021, the Group launched the NESG Podcast services. The NESG Radio is a weekly, syndicated podcast that keeps Nigerians informed through curated localised content on economic policies and issues across sectors of the Nigerian economy. The NESG podcast will help effectively communicate the activities of the Group to a younger audience and extend research-based advocacy in a distillable localised format to all Nigerians. The radio has had guests from the private sector, public sector, civil societies and donor communities speak on issues of national interest. Thus far, NESG Radio has recorded 77 episodes with several episodes translated to local languages for the mass audience.
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Introduction and background

Historical and cross-country review of economic development and transformation has revealed that an effectively thriving market arrangement and private sector is the bedrock of economic growth and share prosperity. Nigeria's economic growth experience has often been fragile, vulnerable, and devoid of shared prosperity for the people. The economic performance has been marred by macroeconomic instability - exchange rate volatility, inflationary pressures, fiscal imbalances and financial volatility. Even in periods of high growth, the economy battled a rising unemployment rate and expanding poverty headcount.

High and sustainable inclusive economic growth cannot be achieved without a functioning market system that guarantees the free flow of economic activities in the supply chain for businesses to thrive, regardless of size, industry or origin. This is because these businesses and firms are the ones to provide the much-needed investments across sectors of the economy, create jobs, bring about innovations and develop new technologies, provide solutions to social problems and create channels for government tax income to provide public goods. The absence of a functioning market system that guarantees businesses' survival and competitiveness to continue providing these social benefits truncates shared prosperity, translating to low (employment) opportunities, high price levels, low standard of living and poverty.

Nigeria's abysmal economic performance rests on the absence of a functional market to create sufficient prosperity that could be shared among the populace. Over the years, private firms have faced a weak economic policy framework, as manifested in policy inconsistencies and multiplicity, regulatory bottlenecks, political and legislative encumbrance, corrupt practices in public service, and predatory and anti-market behaviours of public officers towards businesses. Other factors impeding market efficiency include infrastructural deficiency, high level of informality, widespread insecurity, port congestion, ineffective judicial process and violation of intellectual property rights, proliferation of non-state actors, poor human capital outcomes, ambiguous land administration and weak market and competition governance. These have crumbled the functionality of the market structure in Nigeria, heightening the operating costs, weakening firms' competitiveness, suppressing productivity and dampening shared prosperity.

The success stories of countries such as China, Singapore, South Korea and Taiwan rest on their ability to guarantee a home-built functional market system, regardless of the economic or philosophical alignment. While the experience of these countries has emphasised the importance of other drivers of shared prosperity, they are either efforts supporting market efficiency, or their successes will be truncated by an inefficient market. Therefore, this report defines shared prosperity in the context of developing a functional market system and highlights lessons from China's market reform.

[1] Nigerian Economic Summit Group (2023). Nigeria In Transition: Recipes for Shared Prosperity. 2023 Macroeconomic Outlook Report. Retrieved from https://nesgroup.org/download_resource_documents/2023%20Macroeconomic%20Outlook_1674012875.pdf
[2] See Nigerian Economic Summit Group (2023). Nigeria In Transition: Recipes for Shared Prosperity. 2023 Macroeconomic Outlook Report. Retrieved from https://nesgroup.org/download_resource_documents/2023%20Macroeconomic%20Outlook_1674012875.pdf

Functional market for Shared Prosperity

A functional market system drives efficient and cost-effective production and service delivery across sectors of the economy. The efficiency of the market system forms the core of private sector development, productivity and economic growth, and effective distribution of wealth among the people. It guarantees a seamless flow of economic activities and business operations across value chains and the overall supply chain for firms and businesses to thrive. For the economy to achieve shared prosperity, the market system needs to guarantee the following interrelated but distinct factors:

Business opportunity

An efficient market system brings about competition among players, drives innovation, incentivises productive efforts, and opens sectors of the economy for new opportunities. Without a functioning market system, the existence of mineral, human and atmospheric resources is tantamount to nothing, as investors and businesses in the space cannot thrive.

Enabling environment

A functional market system promotes ease of doing business. It removes all market and regulatory encumbrance, promotes easy market access (input, output and overall entry and exit of firms), ensures the availability of supporting infrastructure, guarantees security and provides regulatory clarity, among others.

Business competitiveness

An efficient market guarantees series of comparative advantages (in terms of inputs, raw materials, capital, production, technology, distribution, market access etc.) that enhances local and international competitiveness, keeps operating cost low and guarantees profitability.

Private investment

The market system needs to be attractive to investors (domestic and foreign investors, which brings about both physical and portfolio investments). If businesses are competitive and the business environment is favourable, impediments to the movement of funds will truncate investment prospects.

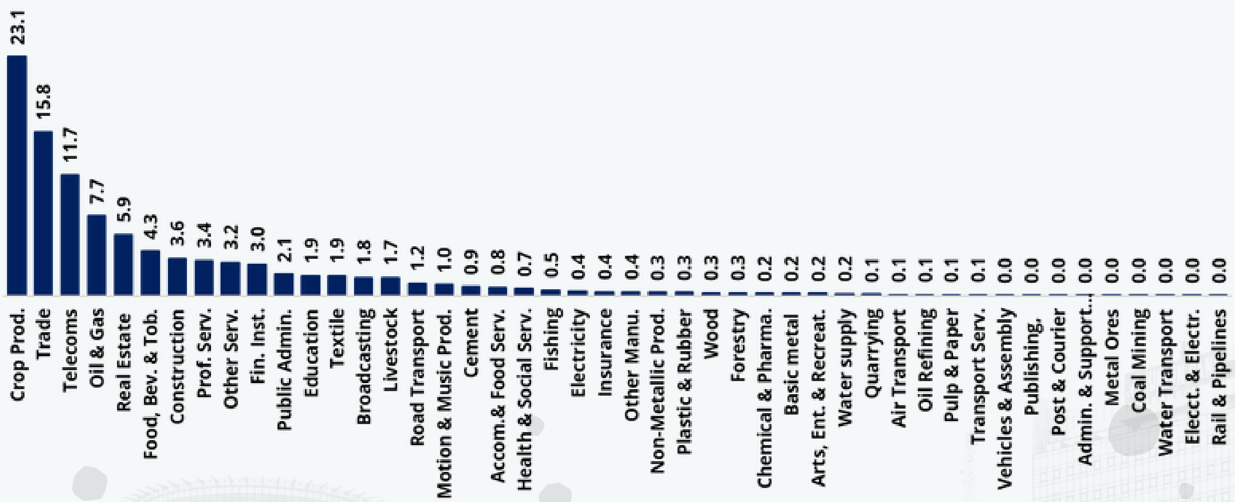
Situational analysis of the market in Nigeria

The current experience of businesses and firms in Nigeria has not shown a significant improvement in the market system over the years. This is also evident as most of the privatised public enterprises found it challenging to survive. Over the past three-four decades, Nigeria has attempted to build a thriving private sector and market economy. Implementing the Structural Adjustment Programme (SAP) in 1986 marked the beginning of a policy shift from a directly controlled economy to a market-driven one where the private sector is used as a catalyst for economic growth and development.

Afterwards, the government introduced several other policies and programmes to establish a market system, among which are the National Economic Empowerment and Development Strategy (NEEDS), the 7 Point Agenda, Vision 20-20-20, Transformation Agenda, Economic Recovery and Growth Plan (ERGP) and recently National Development Plan (NDP) 2021-2025 and Agenda 2050. Critical parts of these policies have come with a continuous reduction of government influence in business activities across sectors. Nevertheless, the market system remains unfavourable for Nigerian businesses and firms.

In terms of ***business opportunities***, Nigeria possesses a progressive human resource base and market potential with over 210 million people, dominated by the youth population. Nigeria is endowed with vast mineral resources base and arable land for agriculture. It has the coastal advantage of being the gateway to West Africa, Central Africa, and Sub-Saharan Africa at large. However, the economic outcomes suggest that business opportunities remain streamlined, with only five (5) of the forty-six (46) sectors accounting for 64.1 percent of economic activities over the past five years. The headwinds to exploring the opportunities in Nigeria include shallow sectoral dynamics (low forward and backward linkage among sectors), legislative, legal and regulatory impediments, logistic and infrastructural deficiencies, stringent and high cost of accessing finance, low human capital outcomes, low population buying power and dependence on imports for inputs.

Figure 1: Distribution of Nigeria's real GDP by Activity Sectors (Percent)



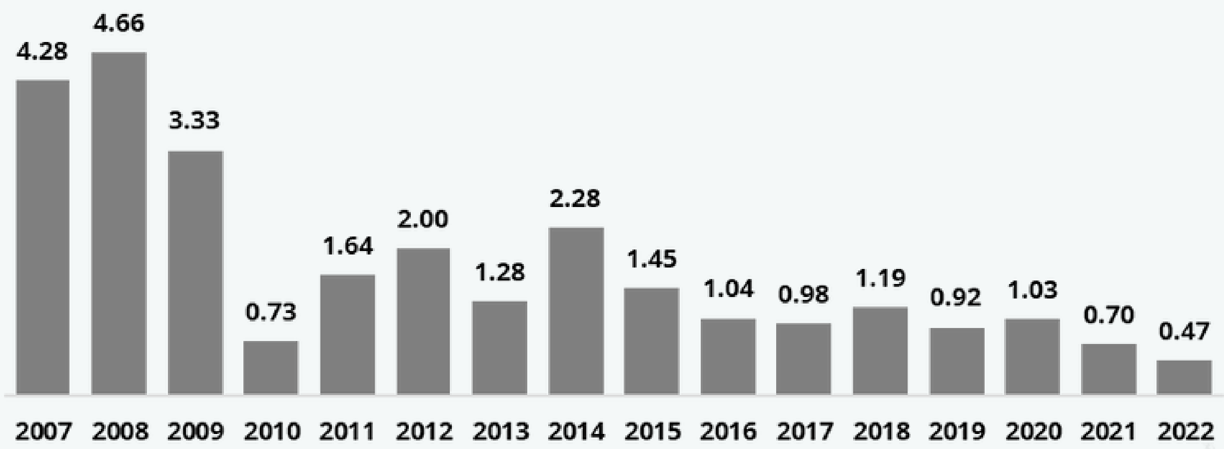
Date Source: NBS I Chart: NESG

In a globalised international market, the ***competitiveness*** of Nigerian firms is low. Nigerian businesses depend on imports for primary and intermediate inputs, technology and, in some cases, technocrats to operate. In the face of an infrastructural deficit, Nigerian firms have to invest in alternatives or make duplicates - power generation, security, transport and logistics, road construction and so on – which come as extra (fixed) costs to the business. In addition, the multiplicity of regulatory institutions, levies, charges, licensing and taxes, as well as the proliferation of non-state actors imposing humongous levies on businesses, is sending many businesses to insolvency. Coupled with macroeconomic instability – inflationary pressures, downward sticky exchange rate volatility and rising cost of borrowing – these issues induce upward pressure on the operating costs, making economic activities in Nigeria uncompetitive and unprofitable for businesses.

Put together, these challenges, as earlier mentioned, inhibit the business environment and make it unfavourable. Therefore, the incentive for private investors (local and foreign) to commit their wealth to the Nigerian economy for the long term to drive shared prosperity is eroded. This is manifested in the subdued performance of Foreign Direct Investment (FDI) inflows which stood at US$468.08 million in 2022, down from US$4.66 billion in 2008.[3] Moreover, Nigeria's investment as a share of nominal Gross Domestic Product (GDP) has experienced a consistent decline since 1999,[4] from 38.3 percent to 14.7 percent in 2017. Despite the recent increase, it still falls below the 1999 performance.[5]

With the Presidential Enabling Business Environment Council (PEBEC), the government has made efforts to improve the business environment. Notably, the government has revised the Corporate Affairs Commission (CAC) guidelines and enacted the Companies and Allied Matters Act (CAMA), 2020, repealing the CAMA 2004. Nevertheless, much more needs to be done to alleviate the impediments to an efficient market in Nigeria, hence, the call for market reform.

Figure 2: Trend of FDI Inflow into Nigeria (US$'Billion)



Date Source: NBS I Chart: NESG

[3] National Bureau of Statistics (2023). Nigeria Capital Importation Q4 2022 Report. Retrieved from https://nigerianstat.gov.ng/elibrary/read/1241308
[4] Central Bank of Nigeria. Retrieved from http://statistics.cbn.gov.ng/cbn-onlinestats/
[5] World Bank Indicators. Gross fixed capital formation (% of GDP). Retrieved from https://data.worldbank.org/indicator/NE.GDI.FTOT.ZS

Market reform lessons from the Chinese Economic Miracle

The economic reform embarked upon by the Chinese government since 1978 chaperoned market reforms that have led to what is called the Chinese Economic Miracle. China operates a "dual-track" economy such that economic activities are still largely centrally planned. Still, it has been able to institute a market system that aids businesses (both publicly and privately), drives investments and develops a private sector that propels economic growth. Consequently, China experienced decades of double-digit growth. As at 2010, China had become the second-largest economy in the world by nominal GDP[6] and the largest economy by GDP Purchasing Power Parity (PPP) as at 2013[7]. The following are key features of the market reforms implemented in China:

Understanding of the peculiarity of the Chinese supply chain

A major feature of China's market reform is that it was based on the characteristics and economic philosophy of the Chinese people. As such, market reforms are made based on a meticulous understanding of the people and how they run their supply chain, contrary to many consensus reforms of the Washington Institutions. This births the idea of the Socialist Market Economy (SME) – socialism with Chinese characteristics. As such, Chinese market reform is not caught up in the war of ideology.

Agricultural revolution through de-collectivisation of agricultural activities

China migrated from collective and communal farming to a Household Responsibility System, which allows families to produce at their own pace and removed the free-riding incentives. While still state-controlled, the government gradually liberalised the Agricultural sector with a stage-by-stage reduction in price control and still buys the major share of agriculture output based on regulatory quota and at near market price. Meanwhile, farmers can sell the excess in the market at competitive prices.

Opening up to Foreign Investment with Clarity on Capital Mobility Control

Following the opening up of the economy, China joined the World Trade Organization (WTO) and agreed to liberalise its foreign exchange market. But in their gradualist manner, China still operates a closed capital account policy with strict rules for capital flow while changes are being introduced. The government, however, is currently using Free Trade Zones (FTZ) as pilots for full currency convertibility and liberalisation of capital flows. Successful implementation at the FTZ level will motivate the consideration of liberalisation nationally.

Gradualist Approach

China's economic miracle is very popular for the graduality involved in market reforms. The transition of economic activities from full state control to the private sector has been gradual. The government makes changes as the market evolves and is not in a hurry to make changes in the market.

[6] World Bank Indicators. Gross Domestic Product (current US$). Retrieved from https://data.worldbank.org/indicator/NY.GDP.MKTP.CD
[7] World Bank (2019). Tracking GDP in PPP terms shows rapid rise of China and India. Retrieved from https://blogs.worldbank.org/opendata/tracking-gdp-ppp-terms-shows-rapid-rise-china-and-india

Decentralisation of state authority and institute results-oriented bureaucracy

The government allows local leaders to experiment with ways to strengthen the market in their locality, to be responsive to business needs, and to promote investments and business growth. The reward for local leaders or public officers is, however, subject to the performance of their local economy in terms of enabling businesses, investment inflows and economic growth. Hence, local and provincial leaders compete to remove regulations and impediments to business growth, investment and the overall market.

Export-led growth strategy

Market development and industrialisation of the Chinese economy was targeted at exporting, just like the Four (4) Asian Tigers - Hong Kong, Singapore, South Korea, and Taiwan. This, however, followed decades of developing a comparative advantage in industrial and manufacturing activities. The government invested, established institutions and made reforms to strengthen and encourage exports. The government consistently reduced tariffs and other trade barriers to achieve this feat.

Tax unification

The Chinese government initially relied on the profit from state-owned enterprises. But with the reduction in state ownership, government revenue was shrinking. Hence, a tax system reform in 1994 unified all inventory taxes into a single Value Added Tax (VAT) of 17 percent. Likewise, there were reforms in other excise taxes to ease the business environment and promote exports. This shored up government revenue substantially.

Symbiotic partnership between the public and private sector

Because the government had historically owned and controlled businesses in the economy, there is a close partnership between the public and private sectors as economic liberalisation evolves in China. The government at all levels made it a priority to remove impediments to the growth of businesses and private investment.

Price reform

The Chinese government gradually and cautiously granted a fair amount of autonomy to producers of consumer goods and agricultural products but much less in the industrial sector. Due to the hardship of inflation on the people, the government is approaching full liberalisation and subsidy removal in phases.

Conclusions

Comprehensive and system-driven market reforms are needed to change Nigeria's economic trajectory from a weak, non-inclusive and highly vulnerable state to one that creates economic value and benefits for all. These reforms need to ensure a conducive and enabling environment for businesses to thrive, invest and create economic benefits and shared prosperity. The experience of China serves as a lesson for many developing countries, especially Nigeria. The features of the Chinese market reforms are pertinent to ensure a smooth policy transition, avoid market distortion, deliver growth and ensure shared prosperity.

Based on the identified features of China’s market reforms, Nigeria is yet to hit the nail on the head. Market reforms in Nigeria are still not organic, often spontaneous and erratic in implementation. Despite not being a centralised government, many reforms that could require regional peculiar intervention rest in the hands of the federal government, while state and local governments are handicapped. The bureaucratic system in Nigeria is largely transactional and punitively designed against the private sector instead of being an enabler. Consequently, a comprehensive market reform bearing the features of the Chinese market reforms needs to be urgently implemented to salvage the crumbling socioeconomic situation in the country.

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About the NESG

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

Our views and positions on issues are disseminated through electronic and print media, seminars, public lectures, policy dialogues, workshops, specific high-level interactive public-private sessions and special presentations to the executive and legislative arms of government.

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