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Trade Liberalization and Its Economic Growth Impact: A Case Study of Nigeria

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Abstract: *This research is a study of trade liberalization and its development impact in Nigeria covering 1988 – 2020. Data sourced from Federal Bureau of Statistics, Central Bank of Nigeria and World Bank were analyzed using the Ordinary Least Square (OLS) regression model. Trade openness (TOPN), real exchange rate (REXR), tariff rate (TRFR) and foreign direct investment (FDI) were discovered to be positive and significant at 1%. Net export (NEXP) was found to be negative and significant at 1%. The study concluded that the variables that have positive relationships with GDP are the ones that are responsible for the economic development of Nigeria within the period of the research and that NEXP does not or contribute negatively to the economic development of Nigeria. The recommendations are that, government should encourage industrialization in Nigeria, encourage local production of export good among others.*

Keywords: *Trade Liberalization, Trade Openness, Real Exchange Rate, Tariff Rate, Foreign Direct Investment, Net Export.*

INTRODUCTION

Trade among nations of the world has been a mutual tie that has binds them right from the period of mercantilism up to the present period. The mercantilists have emphasized on free flow of gold from other countries in exchange for the domestic goods with restriction on imports. This they suggested in order to ensure increase in welfare of the people and internal security for the country. The likes of Smith and Richardo have propounded theory of absolute cost and comparative cost advantage respectively in international trade. The theories suggest the possibility of two countries partnering in trade with each nation producing one or both goods having either absolute or comparative advantage.

The major reason for countries embarking on international trade is to allow for the free flow of goods and services across boundaries due to difference in resources endowment. This process of free flow of goods and services brings about growth and development in the economy of the countries involved. According to Bouët (2008), trade liberalization is expected to bring about economic development and poverty alleviation which the international community has made a target. One of the objectives of Millennium Development Goal (MDG) is to reduce poverty worldwide through welfare improvement. Through international trade, this objective can be achieved because goods and services not produced in one country can freely move to that country thereby increasing welfare and alleviating the poverty of people in such country.

The classical economists have also supported trade liberalization. To them free trade is an engine of growth and restricting of trade or trade protection will result to wastage of resources which will adversely affect economic development. When countries are involved in international trade, there is tendency for surplus resources in one country to move to other countries with shortfall. There is also the possibility of countries competing and learning from their various areas of expertise. These countries can experience increase in income accordingly depending on their comparative advantages and will compete vigorously in the market. This competition avails a number of benefits to them through mutual interaction. In summary, international trade is a positive sum game where both countries benefit.

Objectives of the Study

The major objective of the research is to study the development impact of trade liberalization on economic growth of Nigeria. Other objective is to:

- Ascertain the specific impact of Trade Openness (TOP) on Nigeria's economic.
- Investigate the relationship between Real Exchange Rate (RER) and economic growth
- Study the impact of Tariff Rate (TR) on economic growth in Nigeria
- Establish the nature of relationship between Foreign Direct Investment (FDI) and economic growth.
- Determine the impact of net export on economic growth.

LITERATURE REVIEW

Trade Liberalization

Trade liberalization is the lessening or reduction of trade barriers created by nations of the world to protect their home industries in the manufacturing and agricultural sector and even in services. According to Agbeyegbe *et al.* (2014), trade liberalization is the reduction of trade barriers created by nations around the world. To them trade barriers are meant to protect domestic production in both manufacturing and agriculture from foreign competitors. These trade barriers include the formulation of policies and the use of trade instruments such as; tariff, variable levies, imports and exports duties, quotas and other non-tariff instruments.

According to Talukder (2014), the advocates of trade liberalization argued that it is a growth generator while barriers lead to wasteful use of resource that is capable of retarding economic development. It is believed that openness of trade brings about both static and dynamic gains to countries that practice it. To Talukder (2014), the impact of trade liberalization on economic development is one that has not been finalized and still ongoing. However, majority of opinions have been in favour of trade liberalization but, still with criticisms based on the indicators, model specification and the methodology and approach to research.

According to Arsalan (2010), the reason for trade liberalization is to trade freely without restriction which would bring some benefits to the trading countries. Economically, no country can be independent. A country that closes its borders cannot and will never be an island of its own. Such nation will not import modern technology and so will produce using crude methods, output will increase at a very low rate, it will depend on agriculture with low outputs and wage rate at subsistence level. Moreover, the economy of any nation is a dynamic process. With exposure from travels and bilateral relations with other countries as it is common among nations today, serves as an eye opener and such country opens borders to allow movement of factors of production and inflow of goods and services by relaxing its restrictions. The importation of advanced and technologically improved machines can boost local production which will increase exports. Also the movement of factors of production like skilled labour will allow for transfer of expertise.

The benefits of trade liberalization outweighed its costs. It reduces inefficiency through reallocation of resources in the best possible way. It brings about specialization which leads to static gain in the form of increased output and consumption and a dynamic increase in industrialization that could lead to economic development. The final result is an observable improvement in the nation's welfare which would be seen as only possible with trade liberalization Arsalan (2010).

Shafaeddin (2005), in his study asserted that outward-orientation and liberal trade has favoured countries that practice it especially those of the Eastern Asia and attribute their successes to liberal trade regimes. According to him, the East Asian nations succeeded because of their low nominal tariff and the relative prices of their traded goods were closer on the average to international prices than those of other developing countries of the world.

OECD (2011) opined that as the world recovers from the global economic crises, unemployment becomes high mostly in Europe and North America. Due to the problems created by unemployment, attentions are drawn toward trade liberalization as a means to create employment in these continents and nations that trade with them. It reported that trade liberalization can continue to contribute positively to income, unemployment and productivity growth. In countries with significant involuntary unemployment due to current economic crises, openness of trade of goods can help reduce it in the short run and the long run benefit are substantial increased economic activity and productivity growth. It further summarized that liberalization of trade can be of substantial benefits to the developing nations. The most significant of them are lowering of trade barriers in goods and services through reform of non-tariff and behind-the-border impediments to trade and FDI, which pose more difficult to reform. Trade openness will bring about ease in global imbalances because it will make exports of surplus countries to grow lesser than their imports, while it makes the exports of deficit countries to grow faster than their imports.

Eddy (2005) gave a loose definition of trade liberalization as a move towards achieving free trade by reducing tariff and other barriers in trade because trade liberalization is seen as the engine that drives globalization. According to him, it is responsible for the rapid increase in the flow of goods and services across national borders which have led to increased integration of the global economy in recent decades. His work focused on trade liberalization and employment. Employment is seen as the major determinant of the overall economic welfare especially for underdeveloped countries that have weak system of social security protection. The level and structure of employment induced by trade liberalization to a large extent, affect the extent of poverty, rate of wages and distribution of income and quality of employment.

Amoasah (2018) wrote that Sub-Saharan African countries in their economic history have implemented trade openness as prescribed by the World Bank and IMF as a condition for financial assistance through the introduction of Structural Adjustment

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Program (SAP). The idea behind World Bank and IMF policy was that a market friendly policy will bring about the desired growth in the region. According to him, the level of growth observed in the region is not encouraging as the tremendous growth achieved in Asia. SAP was introduced in Nigeria in 1986 to address the downturn in the economy. At first it was rejected by the government of President Ibrahim Babangida and a state of economic emergency was declared. The acceptance of SAP later led to removal of trade restrictions to allow for inflow of FDI and free trade between Nigeria and other countries of the world. Despite the adoption of SAP, the nation's development did increase as expected despite the purported growth in GDP revealed by government.

Duru *et al.* (2020) reported Bittencourt as saying trade liberalization reallocates resources according to the comparative advantages of participating nations. It also minimizes wastage of resources and makes imported goods cheaper in a transparent economic regime without lobbying and diversification of exports. According to them, trade liberalization is an engine of globalization and a move to realize trade openness in Nigeria was the adoption of SAP as a condition by the World Bank and IMF to obtain loan which could help in providing solutions to the present crises in the economy. The hitherto import substitution strategy was substituted for export substitution strategy and the era was characterized by high import tariffs and export expansion and diversification processes were discouraged by some prohibitions.

Olaifa *et al.* (2013) asserted that the earlier form of trade liberalization prior to SAP was the import substitution strategy in the 1970s which failed due to unfavourable economic environment, He stated further that the adoption of SAP in 1986, led to the elimination of foreign exchange control to reflect economic realities, removal of price control and the stoppage of the commodity board. SAP was intended to create an economic environment that is conducive for business to thrive, ensures inflow of foreign investment, transfer, importation of the required technology and increasing the revenue of government from foreign trade as a means for diversification.

Negative Effects of Trade Liberalization

All have been said about the benefits accruing to countries that implement trade liberalization. Despite the increase in output, income and employment due to specialization according to their comparative advantages, there are negative impact linked to liberalization. According to Arsalan (2010), one of the costs of trade liberalization is the infant industry argument. This argument is about some industries established within the country embarking on liberalization which may not cope with the competition from transnational corporation because they are not well developed. When liberalization commences, the local and underdeveloped industries that do not have the financial strength to import the technology and the skilled labour required by the highly competitive system will be forced out of the market by the foreign industries. In this case, liberalization will result to unemployment rather than creating employment which it was meant.

Secondly, a country with much labour supply like Nigeria will concentrate on raw material development (primary sector production) which may lead to absence of industrialization. The benefit from liberalization is only a static and one time improvement. There should be both static and dynamic gains inform of structural change and industrialization. Trade openness should create more competition that will bring about productivity and efficiency. The growth capacity of participating countries should improve and should also make for improvement of the local industries rather than forcing them out of trade.

Theoretical Framework

The theory that forms the basis for this study is the Heckscher/Ohlin trade theory. The theory recognizes the difference in resource endowment by different countries and the need to partner in trade. It suggests countries exporting products they have comparative advantage in and imports the outputs they have comparative disadvantage. This means that countries should export goods they can produce locally and import products they don't have abundant factors to produce locally. It also emphasizes on the proportion of the factors of production in different countries and the proportion in which they are combined in the production of goods. It assumes trade between two countries with two commodities. It is a model that considers two factors of production at a constant return to scale with the two countries differing in factor intensity and supply.

Empirical Studies

Olaifa *et al.* (2013) carried out a co-integration analysis on trade liberalization and economic growth in Nigeria from 1970 – 2012. The variables of interest were GDP as proxy for growth, openness of trade (OPN), foreign direct investment (FDI), export (EXP) and import (IMP). OLS and Johansen co-integration technique were used to analyze data and they found out that trade liberalization has a positive and significant relationship with economic growth.

The work of (OECD, 2011) was a technical note or a report of a research on the impact of trade liberalization on jobs and growth. The outcome showed that open market in goods and services contributed to job creation and increased income. Reduction of tariff led to slight economic crisis where involuntary unemployment occurred due to reduction in the cost of imported products for consumers and expansion of the export market. Reduction of barriers for Foreign Direct Investment (FDI) in services was found to create jobs for foreigners but did not shift labour abroad from within. It also led to reallocation of resources across sectors and increased economic growth.

Onuora (2018) conducted research on trade liberalization and economic growth in Nigeria from 1990 – 2017. His explanatory variables were degree of openness (DOP), exchange rate (EXR), balance of payment (BOP), inflation rate (INF), foreign direct investment (FDI, balance of trade (BOT) and net export (NEXP) and GDP was the proxy for economic growth. He analyzed his data with OLS and discovered that all the independent variables contributed to economic growth in Nigeria.

Duru *et al.* (2020) examined the relationship between trade liberalization and economic growth in Nigerian. The dependent variable used is GDP per capital growth rate and the independent variables were trade openness, gross fixed capital formation, inflation rate, and general government final consumption. He concluded from his findings that trade liberalization does not support economic growth in Nigeria and so the call for it implementation in developing countries by international organizations in the late 1980s and early 1990s was not necessary.

Amoasah (2018) studied the relationship between trade liberalization and economic growth of Ghana, Nigeria and Cote D'ivoire. The dependent variable was real GDP per capita growth (GDPPCG) while the independent variables were gross fixed capital formation (GFCF), government gross fixed consumption expenditure (GGCFE), inflation rate (INF). Exports (EXP), oil rent (OR), ($GDPPCG_{t-1}$) and dummy equal to zero for GDP growth per capita of Nigeria in 2014 or 1 if otherwise (DUM04NGA). His findings showed that there is an insignificant increase in the economic growth of the countries studied caused by trade liberalization. He discovered that in the post liberalization, exports and trade of the countries increased.

Shafaeddin (2005) analyzed the economic performance of some developing countries that have implemented trade liberalization and SAP in the early 1980s with the intention of expanding exports and diversification of the manufacturing sector. His results showed that forty percent of the countries experienced rapid growth in their export goods. The Asian countries experienced rapid growth in exports and expansion in industrial capacity and upgrading. It was discovered that growth and employment in African and in the Latin America were not satisfactory.

Okoye *et al.* (2016) studied impact of economic liberalization on the growth of the Nigerian economy from 1986 -2015. The variables of studies were GDP growth rate (GDPR) as proxy for economic growth, exchange rate (EXR), lending rate (LR), inflation rate (INFL), financial debt (FINDEP), trade openness (OPNS) and saving rate. OLS model was employed and they concluded that economic liberalization showed no significant effect on output growth in Nigeria while inflation had a negative effect on economic growth.

RESEARCH METHODS

Model and Analytical Techniques

OLS regression model is the model employed for data analysis in this research. It is a modification of the Heckscher/Ohlin model by incorporating more than two variables of the study since it is a linear relationship.

GDP = f(TOPN, TRFR, REXR, NEXP, FDI)

$$GDP = \alpha_0 + \alpha_1 TOPN + \alpha_2 TRFR + \alpha_3 REXR + \alpha_4 NEXP + \alpha_5 FDI + e$$

Where GDP = real gross domestic product
TOPN = trade openness (net export/GDP)
TRFR = tariff rate
REXR = real exchange rate
NEXP = net export (export - import)
FDI = foreign direct investment
μ = error term
α_0 = intercept
α_1 - α_5 = parameters of the model

In order to determine the elasticity of the variables with respect to change in the dependent variable, the variables were converted to natural logs.

$$\text{Ln } GDP = \alpha_0 + \alpha_1 \ln TOPN + \alpha_2 \ln TRFR + \alpha_3 \ln REXR + \alpha_5 NEXP + \alpha_4 \ln FDI + \mu$$

Expectation

With trade liberalization, the degree of openness is expected to be positively related to economic growth. But with the present economic situation in the country marked by high exchange rate and restriction on importation, REXR and TRFR are expected to go in opposite directions.

DISCUSSION OF RESULT

Table 1. Summary of Unit Root Test (ADF)

Variable	ADF T-statistics	Order of Integration	Prob.
GDP	-3.1144	I(1)	0.0041***
TOPN	-4.4146	I(1)	0.0001***
TRFR	-6.3258	I(1)	0.0000***
REXR	-.3.4473	I(1)	0.0017***

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NEXP	-7.9541	I(1)	0.0000***
FDI	-3.5433	I(1)	0.0013***

Note: *** = 1% level of significance

Source: Author's extractions from E-view results

Table 1 is the extractions from e-view results of ADF unit root test. The first column is the ADF statistic which significant at first difference at probabilities less than 5%. The ADF T-statistic are all less than 1% and are significant at 1%. It is an indication that the variables are stationery at first difference.

Table 2. Summary of Regression Result

Independent Variable	Coefficient	T-value	Prob.
C	1.7798	1.7933	0.085**
TOPN	1.8786	3.6756	0.001***
TRFR	1.8593	9.6842	0.000***
REXR	0.5645	2.5330	0.018**
NEXP	-3.7583	7.0726	0.006***
FDI	0.4557	1.9974	0.056**

R-squared = 0.8504, Adjusted R-squared = 0.8805, F-statistic = 45.8458***

Note: ** = significant at 5%, *** = significant at 1%

Source: Author's extraction from E-view regression result.

From Table 1, it could be observed that the coefficients of all the variables except net export have positive relationship with economic growth with TOPN and TRFR impacting more on growth than REXR and FDI. The R-squared value of 0.8504 indicated that about 85% of the growth in GDP was the combination of the contributory effect of TOP, TFRF, REXR and FDI. The F-statistic 45.8458 is statistically significant at 1% which shows the adequacy of the model.

The constant 1.7797 is the autonomous growth and it is significant at 5%. It means that without the other variables, economic growth will take place in Nigeria. The coefficient of TOPN is positive and significant at 1%. About 1.78 of TOPN contributed to economic growth. Coefficient of TRFR is 1.8593 and significant at 1%. It contributed approximately 1.86 of its value to economic growth. REXR has the coefficient 0.5645 at 5% level of significant showing about 0.56 proportion of its contribution to economic growth. The coefficient of NEXP is -3.7583 and statistically significant at 1%. The negative sign implies that growth and net export moved in opposite directions. The growth in net export led to decline in economic growth and vice versa. NEXP reduced growth by approximately 3.76 of its volume. The coefficient of NEXP is a combined effect of import and export. Thus, it shows that the balance between import and export negatively affect output growth in the economy. Finally, FDI is positive and significant at 5%. Its coefficient is 0.4557 meaning that nearly 0.46 of its value was contributed to GDP growth in the country.

Outcome of Breusch-Pagan-Godfrey Heteroskedasticity test.

Table 3. Summary of Heteroskedasticity test

F-statistic	5.7908	Prob. F(6,26)	0.3603
Obs*R-suared	8.8753	Prob. Chi-square(6)	0.4254
Scaled explained SS	4.6281	Prob. Chi-square(6)	0.6333

Source: Author's extracts from e-view

The F-statistic 5.7908 with probability of 0.3603>0.05 (5%) is an indication that there is no heteroskedasticity in the estimated model. It also signifies the reliability of the regression output.

FINDINGS

The discoveries made from the study were that trade liberalization contributed to economic growth in Nigeria. This was indicated by the nature of the signs and significance of TOPN, REXR, TRFR, and FDI despite high exchange rates, the high tariff and the restrictions on importation by the government. The growth in GDP may be due to income earned from abroad by citizens and travels. Another reason may be due to the flow of dollars into the country due to the high exchange rate. The country became an attraction center for trading the dollar.

The only variable that contributes negatively to GDP is NEXP. It went in opposite direction with GDP. This might be due to lack of export goods and the high volume of importation during the period of study. Because of high exchange rate, large numbers of Nigerians are in abroad making money in dollar in exchange for the Naira as they make their trips to

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Nigeria. They import goods from overseas to the country. Import is more than export because the country is not exporting, except oil. The negative net export may bring about the negative impact of net export on GDP growth in the country.

CONCLUSIONS

Findings from this research have shown that trade liberalization brings about economic growth in Nigeria. The variables responsible for growth of output within the time coverage of the study are TOPN, REXR, TRFR, and FDI. These variables are not only positive in their relationships with GDP but, are significant at 1%.

NEXP had negative relationship with economic growth at 1% level of significance. It negative impact on GDP being significant at 1% emphatically indicates that it significantly does not have positive impact on economic growth in Nigeria. As NEXP increases, GDP decreases. If the gap between export and import widens, economic growth will reduce and otherwise.

Recommendations

It is agreed trade liberalization supports economic growth but, preparedness to undertake the process is very important. There has been a set-back in Nigeria's industrialization over a long period. Most of the local industries are closed down with virtually nothing to present at the international market. The government should first revamp the economy by bringing back the old Nigeria of the 1970s and 1980s to work.

Industrialization should be taken serious so that employment will be generated. When we produce goods for export it is then the nation will be able to compete at the international market. The Naira will compete with the dollar and other international currencies. Balance of payment will be favourable as there will be enough Naira in exchange for the dollar.

FDI will be encouraged because foreigners will like to invest in the country due to available business avenues. No one will like to bring huge amount of dollars to Nigeria to waste but rather, to invest and make more money.

The government, in implementing liberalization should be mindful of it consequences on the local manufacturers that may not be able to cope with competition. The local firms should be protected by some policies to ensure expansion and to avoid their discontinuity due to inability to face competition. This will ensure output growth and generation of employment within the country which will in turn increase growth in GDP

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