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# Trade Liberalization and Macro Economic Performance in Nigeria

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A R T I C L E I N F O

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A B S T R A C T

This study examined trade liberalization and macro economic performance in Nigeria. The study made use of ordinary least square (OLS) for analysis using data from pen worth table (PWT) for the period of 1980-2016. The variables used in the analysis are (TOP) trade openness, (UNE) unemployment rate, (GDP) gross domestic product, (XR) exchange rate and (RINT) real interest rate. The result obtained indicates that Trade openness has an inconclusive relationship with the macroeconomic indicators in Nigeria. The implication is that GDP, RINT and UNE were negatively and positively related to Trade openness during the period of review respectively, going against the prior expectation. Hence the study recommends review of the degree of its trade liberalization by keeping trade openness rate below or at ceiling level in order to ensure an improved macro economic performance in Nigeria.

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## INTRODUCTION

Trade has acted as an important engine of growth for countries at different stages of development not only by contributing to a more efficient allocation of resources within countries but also by transmitting growth from one part of the world to another.

Foreign/international trade plays a vital role in restricting economic and social attributes of countries around the world (Akeem, 2011). According to Azeez, B.A et al (2014), "Foreign trade allows for exchange of goods and services cum foster healthy relations among countries irrespective of their level of economic development". A nation not participating in foreign trade is at risk of a slow pace of economic development due to the cogent fact that a country cannot be fully endowed with all the resources essential to be utilized for sustainable economic development. It enables nation to sell their domestically produce goods to other countries of the world (Adewuyi, 2002).

Trade liberalization to Anowor O.F. et al (2013), is the process of reducing or removing restrictions on international trade which may include the reduction or removal of tariff, abolition or enlargement of import quotas, abolition of multiple exchange permits for imports or allocation of foreign exchange. Economist, generally see the concept of trade openness or trade liberalization as the integration among the nations of the world, it is likened to openness of the world economy where nations link together to the extent and financial activities (Igudia, 2014). Economic analysis informs that openness to trade, flow of factors, ideas and information stimulates economic and political progress (Aboagye, 2006, Reich, 1998). Thus, openness to trade can be said to be the platform of globalization while trade, finance, investment and entrepreneurs constitute the heart (Obadan, 2004 Uwatt, 2004).

Ijeoma (2014) opined that one way trade contributes to an increase in economic output is through comparative advantages which create more value with the same resources. Competition typically stimulates real cost reduction and the more competitive situation that prevails after liberalization, the more handwork to reduce real cost than would be under the umbrella of protection. Politically, trade liberalization brings about the inter-dependence of nations and encourages prospects for world peace. Akim (2014) puts it that "Trade liberalization provides incentives for firms to compete, to innovate and to search for new opportunities and markets and firms in protected industries are less likely to innovate or seek new markets".

Trade liberalization is a key economic reform policy and institutional change adopted by Nigeria in 1986 to stimulate its exports (Afaba and Njogo, 2012). These authors are of the view that openness of trade are policy measures that emphasize production and trade along the line dictated by a country's comparative advantage such as export promotion and export diversification, reduction and elimination of imports tariff and the adoption of market-determined exchange rates, some of the aims of the structural adjustment program adopted in 1986 were diversification of the structure of exports, diversification of the structure of production reduction in the over-dependence on imports, and reduction in the over dependence on petroleum exports.

Statistical figure released by the national bureau of statistic shows Nigeria's international trade more than doubled in the 2003-2013 period with exports rising to nearly U.S $50 billion and imports to nearly U.S $34 billion. The study takes further steps to analyze the impact of trade liberalization on Nigerian's economy. Using macroeconomic indicators to analyze the impact of trade openness, these indicators are economic statistics which are released periodically by government agencies and private organization. These indicators provide insight into the economic performance of a particular country or region.

Macroeconomics is a branch of economics, dealing with the performance, structure, behavior and decision making of an economy as a whole. This includes regional, national and global economies. It deals with the study of aggregated indicators such as GDP, unemployment rate, national income, price indices and interrelations among the different sectors of the economy to better understand how the whole economy functions.

Regarding developing countries or economies, the question of the relationship between trade openness and unemployment has been explored with mixed results. In their study of Malaysia, Nanthakumar eta al (2011) find that an increase in the trade balance had negative Granger non-causality effects on the rigidity of unemployment dynamics. This implies that trade liberalization is able to increase aggregate productivity in various sectors. Consequently, economic performance and efficiency raise the rate of labour utilization. In Alawin's (2013) study of the trade balance and UNR in Jordan, using quarterly data for the 2000-2013 periods, his major finding is the absence of a long-term relationship between the two factors. His results reveal that in the short-term, a trade balance deficit leads to unemployment and vice versa. Kim and Sun (2009) find that indicators of trade openness significantly plays a role in labour market chumming in most industries affected by the North American free trade agreement (NAFTA) such as the automobile, chemicals and apparel sectors. This result buttress the argument that trade openness promotes export and ushers in restructuring by some firms, often resulting in the decline of labour use in some sectors and its increase in others.

Advocates of liberalization believe that policy reforms so far has improved economic growth and performance significantly while critics argue that the total withdrawal of restrictions on several matters have had negative effects on future growth and performances of the economy. They are also of the view that liberalization has worsened inequalities across and within the countries, environmental degradation and vulnerability of the poor nations have increased and that developed countries have established dominance over developing countries culminating in neo-colonization. Thus, it is pertinent to find out if trade liberalization has had positive or negative impact on Nigeria's economic performance.

The growth of the industrial sector in Nigeria in the 1970's was the outcome of a policy of import substitution (Ayoninde & Olayinka, 2012), such policy harmed export party through the increasingly over valuation of the domestic currency, partly through the encouragement of low return investments by preferential credit policies. Exposure to world prices generated a process of competitive selection in which some firms could not survive because they owe their existence largely to previously sheltered markets or subsidized input supplies.

The steady rise in the UNR from 1970 to date is caused by the huge number of school dropouts and an increase in job seekers every year with very few trained to opt for self-employment. This situation is also a result of the low savings rate that does not generate sufficient levels of investment and economic activity to lure unemployed workers. Furthermore, the 2007-2008 economic crises further increase the UNR, already in double digits since 200l. This case is reflected by the adverse consequences of the global financial crisis in terms of massive job losses and labour supply exceeding demand. Inflation which is an important factor for consideration in policy decision making has negatively affect economic development and also creates insecurity in the economy. The behavior of inflation dynamics is a longstanding issue in economics. Imported inflation is transmitted from one country to the other particularly, during periods of rising price all over the world (Anyanwu, 1992).

## LITERATURE REVIEW

### *Trade and Imported Inflation*

Imports of intermediate inputs represent a factor of economic growth but they can also de-stabilize domestic economies through price changes and/or competitive pressures on domestic producers of competing products. In general, imports compare with domestic production an influence the way domestic resources are used in stimulating efficiency gain. In brief, trade is another channel of transmission of domestic and external shocks leading to real price effects.

How much of import price changes are neglected in higher domestic costs depend on the share of imported input in total production costs, the way important inputs are priced, and the tightness of the link between import prices and exchange rates. The tighter the link between import prices and exchange Rtes. The tighter the link between import prices and exchange rates, the greater the dependence of exchange rate volatility on the movements of import prices. The later is particularly important for countries which depend on commodity trade.

### *Trade Liberalization and Economic Growth*

Economies of the world have become so international that it has become apparently difficult if not impossible for any economy to function in isolation (Kalu, E.U et al 2016). Trade liberalization according to the protagonists is economic integration for global output expansion, in that, with market liberalization, investment funds can move unimplemented form industrialized countries to developing countries where they are most needed (Anowor, O.F. et al, 2013). Macro economic conditions and performance are affected by trade in different ways. Exports are a component of aggregate demand and are therefore a factor in economic growth. For example , Prassad and Gable (1997) show that the exports of Deco countries serve as a catalyst Of aggregate demand and are therefore, a factor in economic growth. For example, prasseid and Gable (1997) show that the exports of DECO countries served as a catalyst in all economic recoveries, and this positive effect was further correlated with the degree of the economy's openness to international trade. While antagonist argue that trade liberalization is a conscious effort by the western world to deliberately force some of their economic policies that may not be favorable to the receiving economy with the aim perpetually contributing to the under development of the less developed countries. It is seen as another form of post-colonialism strategy which does not promote self reliance, self-determination and indigenization (Ojo, 2005). They also argued that the success of most developed nations is through protectionism and subsides and not because of free trade (Ha-Joon, 2007). It is on this point of view that trade liberalization is defined as integration toward unified economic system dominated by supra-national countries and institutions that are not accountant to democratic processes or national governments (Richard, 2000). In addition, further reasons for the changing perception of liberalization are thus, the lack of tangible benefits to meet developing countries from opening their economies, despite the well published claims of export and income gains which antagonists argue that it is even lesser than economic losses and social disorder rapid trade liberalization has caused many developing countries; they also argue that trade liberalization has led to growing inequalities of wealth, technology, decreasing opportunities both in home and the international community, and the perception that environmental, social and cultural problems have been worsened by the workings of free trade economy (Aja, 1998).

Trade liberalization also brings about expansion in the number of foreign invested firms as their number increases, their labour intensity is likely to increase. This reflect their ability to attract additional labour, relative to additional foreign direct investment (FDI) capital. Labour tends to be fairly mobile within and between sectors and foreign invested firms account for a relatively small proportion of total employment in most economies. Foreign-invested firms should have little from able attracting labour away from domestic firms in their own sector and from other sectors in the local economy. Although the spill-over effects of liberalizing FDI may result in firms that compete directly with the foreign-invested firms, especially domestic firms in the same sector to suffer from lower priced competition, the sectors that use the services of foreign-invested firms as inputs benefit from lower-priced inputs. So long as the liberalization is reasonably widespread across economies, the positive spill –over dominate with within and between economies (DECD, 2011). The importance of trade liberalization in driving dynamic productivity gains and in turn economic growth should not be under appreciated. It is generally accepted that countries can achieve allocative efficiency gains through trade liberalization (Akims, 2014). Allocative gains arising through the (re) allocation of resources to the efficient sectors of the economy represent the traditional theory on the benefits from trade liberalization. In brief, macro economic conditions together with open trade policies and other factors are found by most economists to be the critical in explaining faster economic growth.

*Reasons for Export and Import Trade*

Foreign trade has been regarded as an engine of growth and foreign investment (Adewinyi, 2002). Also, similar to trade openness, the relationship between foreign direct investment (FDI) and economic growth has been a topical issue for several decades. Policy maker in a large number of countries are engaged in creating all kinds of incentives (e.g. export processing zones and tax incentive) to attract FDI, because it is assumed to positively affect economic development.

In Nigeria, foreign trade helps in no small measures to accelerate economic growth. It has helped in the importation of machineries such as tractors, ploughs, industrial plants and equipments. Ozumba and Chigbu (2013), points that the interest to promote non-oil exports was borne out of not just its huge potential for foreign exchange earnings but also for its employment generation and poverty reduction capability through the extensive backward linkages it offers as well as the desire to diversify the country's production base. Export and import trades are known as international trade. Thus, the rationale for international trade includes:

1. Increase in Output: The emergence of international trade has contributed to increased productivity world-wide.
2. Exchange of Technology: International trade creates the opportunity for transfers of technical knowhow and cross fertilization of ideas among nations.
3. Promotes World Peace: With international trade, tribalism, religious and societal inhibitions are fast admonishing; giving way to more peaceful interaction and adaptation between all class of people in different parts of the universe.
4. Efficient Allocation of Resources: World resources are more effectively channeled to more productive ventures by participating countries. It encourages each country to specialize in the production of those goods and services for which its resources are mostly suited.
5. Leads to Market Expansion: Through expanded marks, international trade enables the benefits of large scale production to be enjoyed by participating countries. This economy of large scale production lowers cost of production as well as the general price level.
6. Improve Standard of Living: Different types of products are provided through foreign trade. Products that cannot be produced in a particular country can be traded, thereby increasing the variety of goods and services that are available for human use.
7. To Earn Foreign Exchange: This is the most important reason why countries engage in foreign trade, in order to earn foreign exchange from the sales of their goods and services, increasing their foreign reserve thereby creating a favorable local currency appreciation as well as put

the demand for its goods and services on a high rate thus outing the country at a favorable balance of payment position (Orji, 2007).

Trade and macroeconomic variables do not operate in a vacuum, they are strongly inter-related and inter-dependent. Before explaining the linkages, it may be useful to provide a few instinctive explanations of these linkages. Broadly speaking, the linkages are of two kinds, first macroeconomic variables, such as GDP, employment, price level, aggregate investment and consumption (hence saving) is affected by trade. Trade affects macroeconomics performance in terms of the dynamics of the economy growth, its stability and distribution.

Imports maybe used as inputs in production and therefore, directly affect the level of output and indirectly demand for labour and thus employment. Imports of good reflect choices of consumers and hence their decisions to spend their incomes or to save. In addition, imports compete with domestic production and may displace domestic firms form the market. As a result, domestically produced output will be affected and so will income and employment-adversely, if domestic firms are unable to compete or positively, if they become more competitive. Exports which constitute a component of aggregate demand, stimulate growth of domestic output and hence income and employment by expanding market for domestic firms, exports create conditions for production costs to fall as firm benefit from economic growth.

Trade is also sensitive to changes in macroeconomics policies. For example, an expansion in monetary or fiscal policy will increase aggregate spending which includes spending on imports and influence the allocation of resources between tradable and non-tradable. Macroeconomic policies also affect the conditions in financial markets and thus the incentives for capital flows to move in and out of the country. This, in turn, is a determining factor of the amount of external resources available for financing current account deficits.

This study attempts to test the following hypothesis;

Ho: GDP has no significant impact on Nigeria’s trade liberalization.

H1: GDP has a significant impact on Nigeria`s trade liberalization.

Ho: Real interest rate has no significant impact on trade openness in Nigeria.

H1: Real interest rate has a significant impact on trade openness in Nigeria.

Ho: Unemployment rate has no significant effect on trade openness in Nigeria.

H1: unemployment rate has a significant effect on trade openness in Nigeria.

Ho: Exchange rate has no significant effect on trade openness in Nigeria.

H1: Exchange rate has a significant effect on trade openness in Nigeria.

## METHODOLOGY

The model employed in the study is a linear regression model which is in form of

TOP = (Xi) -------------------------------- (I)

Where; TOP = Trade openness

X = Set of chosen explanatory variables

The chosen variables are reflected in the model

$Y = bo + b1x1 + b2x2 + b3x3 + b4x4 + \mu$

TOP = F (UNE, GDP, XR, RINT) ------------------ (II)

Where; TOP = Trade openness (trade liberalization)

UNE = Unemployment Rate

GDP = Gross Domestic Product

XR = Exchange Rate

RINT = Real Interest Rate

Rewriting the above model in linear form;

TOP = Bo + bI UNE + b2 GDP + B3 XR + B4RINT + μ -----------------------(III)

Where

TOP = Trade openness

bo = Constant or Intercept

bI + b2 + B3 + B4 = Coefficient or parameter

μ = Stochastic error term

UNE = Unemployment Rate

GDP = Gross Domestic Product

XR = Exchange Rate

RINT = Real Interest Rate

$Y = bo + b1x1 + b2x2 + b3x3 + b4x4 + \mu$ ----------------------------------------(iv)

Where

Y = Trade Openness

Xi = Unemployment rate

X2 = Gross domestic product

X3 = Exchange rate

X4 = Real interest rate

## RESEARCH RESULT AND DISCUSSION

*Steps to test your results here*

Diagnostic test of the model were carried out using the coefficient of multi determination analysis of variance and Durbin Watson statistics. The results are stated in table 1. below:

Table .1: Diagnostic Test Result for Hypothesis One

| Test Statistic | Value |
|---|---|
| $R^2$ | 0.984451 |
| Adjusted $R^2$ | 0.982508 |
| F-Statistics | 506.5141 |
| Prob (F-statistics) | 0.0000000 |
| D.W | 1.533477 |

Source: Regression Result

R2, the coefficient of multiple determinations was used to test the explanatory power of the model and goodness of fit. From the result adjusted for degree of freedom is 0.984451 (table 4.1). This indicates that 98% of systematic variations in the dependent variable are explained by change in the independent variable in the model.

To test the overall significance of the regression, analysis of variance (ANOVA) is 506.5141 and prob (F-Statistics) is 0.000000. Testing the null hypothesis that the coefficients are equal to zero at 5% level of significance, we reject the null hypothesis since the prob (F-Stat) is less than 0.05 in each case. We therefore conclude that the independent variables have significance impact on the dependent variable in the model.

Durbin Watson statistic was used to test for the presence of autocorrelation.

Decision Rule: If a computed value of Durbin Watson (d) is less than the lower limit (dl), therefore evidence of positive first order serial correlation, if it is greater than the upper limit (du) there is no evidence of positive first order serial correlation but if it lies between the lower and upper limits, it is inconclusive. In table 4.1, the Durbin Watson (d) statistics is 1.533477, therefore, since the d value lies between the dl and du (ie) 1.193 and 1.730 respectively, it shows that the first order serial correlation is inconclusive.

*Cointegration Test*

Table 2. Johanson Co-integration Test

| Eigen Value | Likelihood | 5% Critical Value | 10% Critical Value | Hypothesized |
|---|---|---|---|---|
| 0.638917 | 82.47211 | 68.52 | 76.07 | None |
| 0.524074 | 46.811945 | 47.21 | 54.46 | At most 1 |

| | | | | |
|---|---|---|---|---|
| | | | | |
| 0.26668979 | 20..83211 | 29.68 | 33.65 | At most 2 |
| 0.207611 | 9.8666277 | 15.41 | 20.04 | At most 3 |
| 0.048000 | 1.721664 | 3.76 | 6.65 | At most 4 |

denotes rejection of the hypothesis at 5% (1%)

Significance level L.R test indicates 1 co integrating equation (s) at 5% significance level.

Looking at the likelihood ratios as compared to the critical value at 0.05, the hypothesis of co integrating or the existence of the most one co integrating vector was rejected. The result shows that there are one co- integrating equations (vectors) in the set of normalized co- integrated vectors. This means that there is long run relationships between the variables.

Table 3. Short Run Estimates Result

| Variables | Coefficient | t-probability |
|---|---|---|
| ECM (-1) | -0.0496695 | 0.0419 |

From the result in table 4.3 above, since the coefficient of ECM (-1) which is 0.000049695 is negative, we say that there is convergence and also the probability 0.049695 is significant at 0.05 level of significance.

Table 4. Philip Perron (Pp) Unit Root Test Results

| Variables | Level | 1st difference | 2nd difference | Order of intg. |
|---|---|---|---|---|
| TOP | -1.356736 | -6.645756* | -14.52090* | 1(1) |
| UNE | -0.795011 | -4.996608* | -9.194369* | 1(1) |
| GDP | 1.518161 | -5.088969* | -11.56994* | 1(1) |
| XR | -1.638502 | -5.315099* | -11.22548* | 1(1) |
| RINT | -1.255551080 | -5.795097* | -12.07543* | 1(1) |
| Critical Value | | | | |
| 1% | -4.2324 | -4.2412 | -4.2505 | |
| 5% | -3.5386 | -3.5426 | -3.5468 | |
| 10% | -3.2009 | -3.2032 | -3.2056 | |

signify significance at 1%, 5% & 10% respectively.

Source: Authors Analysis, 2020

The result in table .3 shows that all the variable where stationary at first difference, since the absolute value of the Philip Perron (PP) unit root test was greater than 5% chosen critical value.

*Answering Of Research Questions*

The research questions were answered using the coefficient of the independent variables. The regression results are displayed in table 5.

Table 5. Regression Result

| Variables | Coefficient | Std. Error | t- statistic | Prob |
|---|---|---|---|---|
| UNE | 0.404530 | 0.916954 | 0.441167 | 0.6621 |
| GDP | -5.00E-07 | 1.84E-06 | -0.271144 | 0.7880 |
| XR | 0.273961 | 0.129114 | 2.121854 | 0.417 |
| RINT | 0.913471 | 0.036637 | 24.93303 | 0.0000 |
| C | 0.490638 | 24.69042 | 0.0119822 | 0.9843 |

Source: Author's Analysis

The result of the regression can be summarized in equation form as follows;

TOP=0.490638 + 0.404530UNE – 5.00-07GDP + 0.273961XR + 0.913471RINT

S.E = (24.69042) (0.916954) (1.84E-06) (0.129114) (0.036637)

t = (0.019872) (0.441167) (-0271144) (2.121851) (2.493303)

Research Questions

i. What is the impact of GDP on trade openness in Nigeria?
From the regression result stated above (table 4.4) the macro economic variables GDP has a negative impact which is shown by the negative coefficient. This means that when there is increase in openness of trade reduction in tariff or import duties, GDP tends to reduce (i.e.) -5.00E-07.
ii. What is the impact of real interest rate on Nigerian's trade openness?
Based on the regression output stated above, (table 4.8) the RINT has a positive impact on TOP (i.e.) 0.913471.
iii. To what extent does unemployment rate have an effect on Nigerian's trade openness?
From the regression result stated in (table .4) above, the unemployment has a positive relationship with trade openness. This can be seen in the positive coefficient which is 0.404530.
iv. What effect does exchange rate have on trade openness?

Exchange rate has a positive effect on trade openness. This can be seen in table 4.4 where the coefficient of exchange rate is seen to be 0.2773961.

*Test Of Hypothesis*

The hypothesis was tested using the t-probability.

Decision Rule: If the t-probability is greater than the 5% critical value we accept the null hypothesis otherwise, we reject the null hypothesis when significant Prob is less than 0.05.

Ho: GDP has no significant impact on Nigerian's trade openness.
From the table .4, since the t-probability (0.7880) is greater than critical value of 5%, we accept the null hypothesis. This follows that GDP has no significant impact on TOP In Nigeria.

Ho: RINT has no significant impact on trade openness in Nigeria.
From table .4, since the t-probability (0.0000) is less than 0.05 critical value, we reject the null hypothesis and conclude that RINT has a significant impact on trade openness in Nigeria.
Ho: Unemployment has no significant effect on trade openness in Nigeria.
From table .4 since the t-probability (0.6621) is greater than the 5% critical value. We therefore accept the null hypothesis and conclude that UNE has no significant effect on TOP in Nigeria.

Ho: Exchange rate has no significant effect on openness in Nigeria.
From the table .4 above, the t-probability which 0.0417 is less than 0.05 critical value, we reject the null hypothesis and conclude that exchange rate has a significant effect on TOP in Nigeria.

**CONCLUSIONS AND RECOMMENDATIONS**

The importance of trading at the international market has necessitated the adoption of trade liberalization by most of the economies around the globe which is aimed at easing flow of goods and services between trading countries. The degree of trade liberalization have been argued to determine the level of exchange activities that is export and import which has a long way to determine the balance of trade of the countries involved. Nigeria not left out has also adopted trade liberalization and trade liberalization since 1986 with the aim of seeing its exportation rise. This work was prompted by the need to understand the response of some macro economic variables to trade tariff liberalization policy in Nigeria. This is particularly important in view of the government revenue, diversification and the need to meet its multilateral trade obligations. A quantitative finding suggests that the impact differs based on the particular macro economic variables used. Macro-economic variables such as GDP is negatively related to TOP which means that or suggest that import duties cuts dampen productivity and this may be due to the constrained domestic production due to the influx of similar imported products, while other variables such as UNE, RINT and XR are positively related to TOP. These variables such as UNE, GDP and RINT in this work do not conform with what

Oruta (2015) POINTS "To increase the level of employment, some scholars have argued that the flow of goods and services (Trade flows) covered propel employment generation, especially in developing countries. Painta and Virareli (2006) cited in Oruta (2015) stated further that growth in employment has a feedback on economic growth, such that an increase in income would expand domestic demand, which in turn will lead to sustainable GDP growth and reducing markets.

Hence, with the study and that of others (empirical investigations), it is discovered that it is inconclusive on whether trade liberalization is or has a positive relationship with the macro economic variables such as UNE, GDP and RINT

The following recommendations have made for the study;

1. Government must review the degree of its trade liberalization by keeping trade openness rate below or at certain level in order to ensure an improved macro economic performance.
2. Government should checkmate the reduction of import duties in order to get conclusive answer whether or not trade liberalization has a positive impact or effect on economic growth and stability.
3. Government should check the inflation dynamics so as to avoid imported inflation which are often transmitted from one country to the other, particularly during periods of rising price all over the world.
4. Government should also checkmate the infant industries or domestically produced goods in order to ensure unconstrained domestic production of goods which will reduce unemployment rate and in turn increase the GDP,

**ADVANCED RESEARCH**

This research still has limitations so it is necessary to carry out further research related to the topic "Trade Liberalization and Macro Economic Performance in Nigeria" to perfect this research, as well as increase insight for readers.

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