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TRADE OPENNESS AND INDUSTRIAL OUTPUT GROWTH IN NIGERIA: EMPIRICAL LESSONS FOR DIVERSIFICATION

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Abstract: *This study examines the relationship between trade openness and industrial output growth in Nigeria using time series data, endogenous growth framework as well as export-led growth model. The adopted framework contends that domestic policies on trade liberalization cannot be avoided but harnessed for optimal benefit of the economy. The empirical results show that trade openness contribute positively to industrial output growth and supports general economic diversification. In the short-run, the dynamic impact of trade openness on industrial output growth is insignificant while its long-run impact is significant.*

Keywords: trade; openness; industrial output; growth; Nigeria.

JEL Classification: F13 ; F14 ; L50 ; L60 ; O24.

Introduction

In many developing economies, discussions on trade openness and industrial output determinants have received some serious attention. This is largely due to various contenting arguments in the literature and the relatively declining performance of the industrial sector in these economies. Having realized the backwardness associated with protected trade policies to earn economic success; developing countries in Africa including Nigeria are implementing trade liberalization policies. However, to achieve some sustainable levels of growth and greater diversification in any economy through the expansion of the industrial sector, domestic policies on trade openness and liberalization have critical roles to play.

Many economists and policy commentators see economic development as being synonymous with industrialization or modernization. It is also widely accepted that the speed of industrial development is dependent on domestic policies and organization of international trade; hence the importance of studying how economy grows is also linked to trade openness, industrial output and diversifying away from traditional commodities.

Nigeria is a monoculture economy which depend majorly on crude oil production with neglect in other areas of investments resulting to fall in foreign exchange earnings, high rate of unemployment and inflation due to lack of investment in other key areas. Indeed, industrialization has been a top priority of government to move population out of poverty. Thus, focus has been on identifying factors capable of boosting industrial performance in Nigeria, among the key issues are openness of trade and industrial output growth leading to diversification.

The manufacturing sectors performances in Nigeria have not been impressive due to the preference and reliance on imported goods. The poor performance may be for other reasons such as policy instability, poor macroeconomic environment, bureaucratic bottlenecks, legal environment which does not guarantee property rights and safety, poor governance, corruption and low commitment of governments to industrial development (Albaladejo 2003). It could be the case of high rise of importation of production input that may hinder industrial performance in Nigeria. Ajakaiye, Jerome and Alaba (2016) argued that the sharp depreciation of the naira adversely affected the manufacturing firms because of the increasing cost of importation of spare parts and infrastructural deficit, weak demand resulting from declining domestic purchasing power, high interest rate and gross under-utilization of capacity.

It is worthy to note that the adoption of the structural adjustment programme (SAP) in 1986 initiated the process of termination of the hostile policies towards trade. A new industrial policy was introduced in 1989 with the debt to equity conversion scheme as a component of portfolio investment. In summary, the polices embarked on by the Nigerian government to attract foreign investors as a result of the introduction of the SAP could be categorized into five: the establishment of the Industrial Development Coordinating Committee (IDCC), investment incentive strategy, non-oil export stimulation and expansion, the privatization and commercialization programme, and the shift in macroeconomic management in favour of industrialization, deregulation and market-based arrangements (Mba 2010, and Orji and Mba 2011).

The second trade policy created the National Economic Empowerment and Development Strategy (NEEDS) in 2003 which was a medium-term economic strategist covering 2003-2007. According to African Trade Policy Centre (2007) NEEDS was described as Nigeria's plan for prosperity and vision for greater tomorrow with focus on: re-orienting values, reducing poverty, creating wealth and generating employment. In the trade policy area, it deepens Nigeria's integration with the rest of the world and maximizes the benefits of strategic integration with regional integration and trade as the two instruments. However, the impact of these policy thrusts on our economic performance still remains ambiguous.

Against this background, this article examines the impact of trade openness on industrial output performance, and equally draws some lessons for diversifications.

1. Literature Review

Smith and Ricardo's theory commonly known as the orthodox or traditional theory of international trade by the classical economists argues that trade will promote growth and development in the form of higher production and consumption. But the theory attracted lots of criticisms from the modern trade theory due to its bases on unrealistic assumptions such as the assumption of labour cost; since it neglected other cost like capital. The Heckscher-Ohlin-Samuelson (HOS) model postulates that trade will help in reducing the income gap between poor and rich countries. Therefore, countries that have abundance labour (L) should use more of labour in production while the ones that have capital abundance should use more capital (K) in production so that at the long run, the gap of inequality will be wiped out.

In other words, HOS imply that poor countries with abundant labour should specialize in producing and trading in labour intensive goods while the richer countries with relatively scarce labour but abundant capital should specialize in capital intensive commodity. It also implies that free trade specializing in production will tend to bring about factor price equalization and thus increase the return to labour in poor countries that will be equivalent to the rich countries. This is based "on the assumption that some factors of production" are perfectly immobile internationally. The HOS model is found by utilizing Heckscher's observations such as: (i) countries differ in their relative endowments of the factors, (ii) production processes for different goods employ different relative intensities of the factors. Thus, the HOS have a growth dimension with implications for future outputs and trade patterns (Verick 2006).

Dunning (1981) put forward his eclectic integrated approach to international trade. He observed that technology is not the main determinants that give a country advantage over another country through internationalizing. Internationalization could occur through transfer, price manipulation, security of supplies and markets and control over use of intermediate goods. While Caves (1971) opined that avoidance of oligopolistic uncertainty and erection of barriers to the entry of new rivals are the factors underpinning the investment decision in LDCs. This observation was further enhanced by the deficiencies of capital, technology and expertise to exploit and enhance the natural resources that abound in the less developed countries.