Trade Liberalization - Implication for Informality in Nigeria

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Abstract

This study examined the dynamic response of informality to the openness of the Nigerian economy over the period 1970 to 2011. The study used ordinary least squares (OLS) methodology. The results of the long-run model indicate that openness (though not statistically significant) increases informality, while state regulatory activities impact significantly and positively on informality in Nigeria. The study recommends that policies that encourage openness in Nigeria should be carefully implemented so that informal activities in the external sector (which are predominantly illicit) can be curtailed. Also, excessive/repressive state regulatory activities that could drive economic units underground should be avoided.

Keywords: Trade Liberalization; Informality; OLS; Cointegration; Nigeria

Introduction

The informal sector can be defined as market-based production of goods and services, whether legal or illegal, that escape detection in the official estimates of gross domestic product (GDP). The activities in this sector cover almost every field of economic activity, ranging from petty trading and personal services to informal construction, manufacturing and repairs (Smith, 1994; Ajakaiye & Akerele, 1996; CBN/FOS/NISER, 2001; Oduh et al, 2008). In Nigeria, the activities in this sector include several small and unregistered sole proprietor businesses, and in some instances, joint-partnership businesses which can be found both in rural and urban settlements across the country. However, the nature of the economic activities engaged in varies considerably from one locality to another. For example, in the rural areas, farming activities and allied occupations such as hunting, fishing, weaving, blacksmithing, basket and pot making as well as leather works are more prevalent. However, in urban centres like Lagos, Enugu, Abuja, Port Harcourt, and Kano, informal economic activities include trading, small scale manufacturing and repairing industries, such as carpentry, upholstery, furniture making, woodworks, metalworks, bakery, goldsmithing, tailoring, bricklaying, and printing. Those in the repairing occupations include, among others, the automobile mechanics, electricians, clock and watch repairers, and cobblers, (Olowu & Okotoni, 1996).

Apart from the economic activities enumerated above, numerous informal sector activities in contemporary Nigeria are illicit, especially those conducted on the external scene. These activities include drug peddling/trafficking, currency trafficking, money laundering, smuggling, advance fee fraud (419), over invoicing / under invoicing, 'crude oil bunkering' or theft, kidnapping for ransom, illegal arms trade, human trafficking, among others. Ezeobi (2012) estimated that Nigeria lost about $7 billion to crude oil theft in 2011. Obviously, the main feature of the enterprises in this sector is that they

typically operate outside the regulatory capture (that is, not registered with the Corporate Affairs Commission and so do not subscribe to both corporate income tax and Pay-As-You-Earn tax), and hence could significantly reduce potential state revenue (Fleming, Roman & Farrell, 2000; Gbanador, 2007).

From the foregoing, it can be deduced that the increasing quest for trade liberalization or openness of the Nigerian economy to international trade can encourage the emergence and growth of the illicit activities of the Nigerian informal sector. In other words, it is expected that the more open the economy is the higher the size of the informal sector. Unfortunately, none of the existing studies on informality in Nigeria has empirically examined the response of the informal sector to trade liberalization. This study seeks to address this research gap. Specifically, the objective of this study is to determine the impact of trade liberalization on informality in Nigeria in order to provide evidence based policies that will enhance the growth and development of the Nigerian economy. This study is therefore a major step towards eliminating dualistic markets and promoting a well functioning national economy in Nigeria.

Theoretical Literature (Theories of Informality):

Several theories have been developed in the attempt to understand the concept of informality. These include: modernization, dependency, structuralism and neo-liberalism theories (Yusuff, 2011).

Modernization Theory: The main proponent of the modernization theory is Rostow (1960). He characterized informality in the less developed countries largely as a "social problem" internal to and caused by the backward socio-economic systems of individual countries. According to him, the policy prescription was for these countries to acquire "modern" values, "modern" legal institutions and political systems, and "modern" capitalist economies. In most cases, the "modern" was understood as being synonymous with western values, institutions, and market economies. In essence, the issue of informality is not rooted in capitalist exploitation and extraction (as argued successively by neo-Marxist and dependency theorists), rather these countries had not yet been sufficiently incorporated into the modern world or the international economy. Thus, it is only a matter of time and these countries would "take-off" and "catch-up" with the developed countries. Proponents of modernization theory saw the informal sector as a remnant of traditional, pre-capitalist modes of production and subsistence strategies common to isolated rural communities such that informal sector economic units were trapped outside the modern economy because they lacked proper education, skills, and value orientations. The main weakness of the modernization theory is that the informal sector is neither seen as an important component of the overall economy that can engender economic growth, nor as a reservoir of entrepreneurial training and talent. It is seen as a problem to be solved and not a development strategy to be harnessed and promoted.

Dependency Theory: It was the pioneering works of ILO (1972) and Hart (1973) that crystallized the phenomenon of unregulated economic activity into the term "informal sector". Hart's contribution had such a broad and original impact because he focused on the complex, organized, and dynamic income generating activities of informal