SUPPORTING ECONOMIC TRANSFORMATION

REINVIGORATING ECONOMIC TRANSFORMATION IN NIGERIA

BRIEF

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Key messages

- Nigeria’s recent economic growth has not brought economic transformation. New areas of economic growth need to be identified and supported as a matter of urgency. This is one of the fundamental challenges facing the incoming government in 2015.

- New administrations have an opportunity to set high aspirations combined with tangible policy deliverables. The leaders of several other large economies have done this, creating the domestic political consensus necessary to undertake successful reforms.

- One conclusion that emerges clearly from the experiences of other countries that have achieved economic turn-around is the importance of emphasising global competitiveness, even in a large economy with a growing domestic market.

- Six aspects of policy formulation and implementation appear crucial from the relevant international experience: (1) the timing of policy change, (2) the consistency of policy packages, (3) clarity of objectives, (4) gathering support for policy changes, (5) the importance of early wins as well as commitment to long-term objectives, and (6) the importance of monitoring, evaluation, and corrective feedback mechanisms.

- A key feature of Nigeria policy-making process is inconsistency, which works directly against the key ingredients for successful transformation policy.

- The possible entry-points for improving the pattern and quality of economic growth in Nigeria are numerous and varied. A good range of industrial sectors and products appear economically promising on the basis of any one of three types of rigorous analytical methods (Revealed Comparative Advantage, Product Space Analysis, and the Growth Identification and Facilitation Framework).

- Alleviating constraints to growth in these sectors is likely to involve: (1) targeted and core infrastructure (in power, integrated transport network, aviation); (2) improved access to finance; (3) reduced business environment costs; (4) lower import protection and lower trade costs; and (5) skills building, particularly through entrepreneurial and management training, and human capital development generally.

- Countries that have successfully engaged in economic transformation have been able to both articulate a longer-term economic vision and to deliver on a sufficient number of deliverables to obtain cooperation from various parts of society. One aspect of this articulated vision involves transparency of actions. Another involves coordinated follow-through. Broadly speaking, the identification of technical possible solutions must be married with targeted improvements in governance so as to create a domestic constituency for reform. In other words the benefits of economic transformation must be clear, widely distributed, and not captured by a few. Where these conditions have obtained, transformations have led to improved development outcomes.

- Successful economic transformation, even within a single sector, involves getting many things right, in a coordinated way. What is needed in Nigeria is bold and imaginative thinking about technically sound and politically feasible first steps. In the immediate future this may mean being selective: demonstrating what policy for economic transformation looks like by concentrating on a limited number of promising sectors and taking an entrepreneurial, learning by doing, approach to what is required.

Nigeria's economic transformation challenge

Nigeria was one of the fastest growing economies in the world over the past decade, but notwithstanding some encouraging signs of recent change, growth has not brought economic transformation. Poverty has declined slowly at best. Now, with oil prices down significantly, growth forecasts have been cut. New areas of economic growth need to be identified and supported as a matter of urgency. This is one of the fundamental challenges facing the incoming government in 2015.

The new government must confront the unpleasant reality that neither size nor wealth guarantees economic progress and the massive welfare gains that the Nigerian citizenry expects. A forward-looking and practical approach is needed; past mistakes are water under the bridge. But decisions about options and priorities should be founded on full awareness of the scale of the challenge created by missed opportunities in the past. They also need to be informed by knowledge of relevant international experience, especially what has been done to turn around other large, emerging economies in similar circumstances.

New administrations must set high aspirations combined with tangible policy deliverables. The message to all economic actors must be that a new set of policies is coming. Looking at Mexican President Peña Nieto's first few months in office may be instructive. He took on areas previously ignored by policymakers, including privatisation of the national oil sector, labour reform, and fiscal reforms. Nigeria's incoming government must take the same pro-active approach in identifying policy bottlenecks to growth and designing implementable and coordinated transformational policies in a number of overlapping areas. Several other large economies have done this and have created the domestic political consensus necessary to undertake successful reforms. Ways of emulating these experiences that are adapted to the distinctive political economy of Nigeria can and must be found. Box 1 suggests a number of issues the new government administration should consider in the short run and medium term.

BOX 1: KEY TASKS FOR THE NEW ADMINISTRATION

The new government must confront challenges, pursue a number of solutions and tackle a number of immediate obstacles in economic governance.

In the **long run**, the government has to confront major economic challenges:

- Lack of significant GDP per capita growth - despite recent growth, Nigeria's GDP per capita has not increased as much as it comparators in Asia over the last 3 decades
- Low level of investment - Nigeria's gross fixed capital formation as percent of GDP is the lowest of its comparators in Africa, Asia and Latin America
- Lack of industrialisation - whilst the share of services and manufacturing in GDP has increased in the rebased data, Nigeria's share of manufacturing in GDP is still the lowest of its comparators in Africa, Asia and Latin America
- Lack of competitiveness – 40% appreciation of the real effective exchange rate over the last 5 years
- Low levels of security and economic stability after the drop in oil prices and the attacks by Boko Haram
- Presence of significant binding constraints to transformation – weaknesses in infrastructure, finance, and skills. Energy infrastructure and production supply are not up to required standards. Nigeria need to be on a path of diversification, productivity increases and enhanced competitiveness by building skills for a modern economy, especially in the North and through a trade and competitiveness policy for agriculture and manufacturing.

In the **first 100 days** the government needs to show that it can tackle immediate obstacles in economic governance:

- The new government should chart out a new path with new aspirations for Nigeria and set out a number of tangible policy deliverables which it needs to pursue consistently. In order to do this, it should establish an independent advisory group to help set out economic goals for years 1-3-5.
- More specifically, the new government should
    - establish an inter-ministerial group to prepare a list of deliverables that remove significant binding constraints to inclusive economic transformation,
    - identify a priority list of promising sectors where new investments would demonstrate the potential gains from a process of economic transformation (these could be led by public investment, but more likely would involve government facilitation of private investment),
    - identify ways to improve the dispersion of economic benefits that result in a list of measures to be drawn up based on inputs from an advisory committee from the North, and examine ways to raise non-oil government revenues needed for investments in quality public goods.

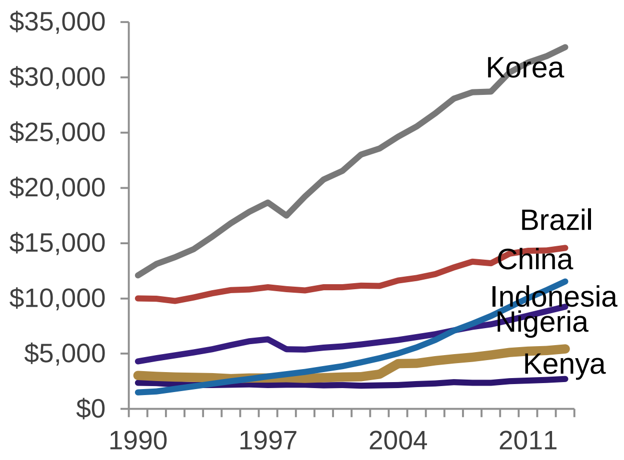
This briefing starts with a wake-up call. The first section reviews the comparative evidence on economic transformation in Nigeria and other large developing countries, pointing to the scale of the challenges. After noting some recent encouraging signs, Section 2 examines how other successful countries have supported economic transformation and what this means in relation to the way economic policy is currently made in Nigeria. Getting more specific in Section 3, we apply a set of tools to establish a short-list of sectors offering particular promise in the next phase of Nigeria's economic transformation, with corresponding areas for priority policy action. We conclude with some remarks on the challenge of making economic transformation politically feasible in Nigeria, with some thoughts on practical first steps.

The scale of the challenge: a wake-up call

It is important not to underestimate the size of the challenge and the scale of what needs to be done. In this section, we begin by reviewing Nigeria's economic transformation experience to date using standard forms of economic analysis – macro-analysis, labour productivity, export performance and firm-level productivity. We also apply the Hausmann's Economic Complexity Index to situate Nigeria in relation to comparator countries.

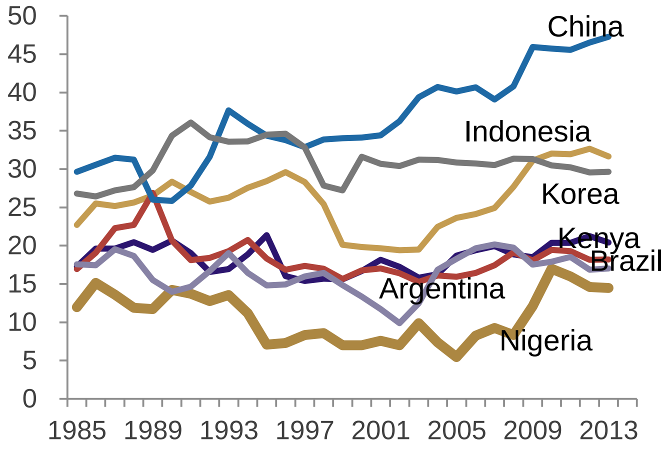
Nigeria's Gross Domestic Product (GDP) per capita has increased in recent decades, but over the long term GDP per capita growth has fallen behind several other countries such as Indonesia and China (Figure 1). This is largely due to a very low level of investment over the years (Figure 2).

Figure 1 GDP per capita (constant 2011 prices)



Source: World Development Indicators

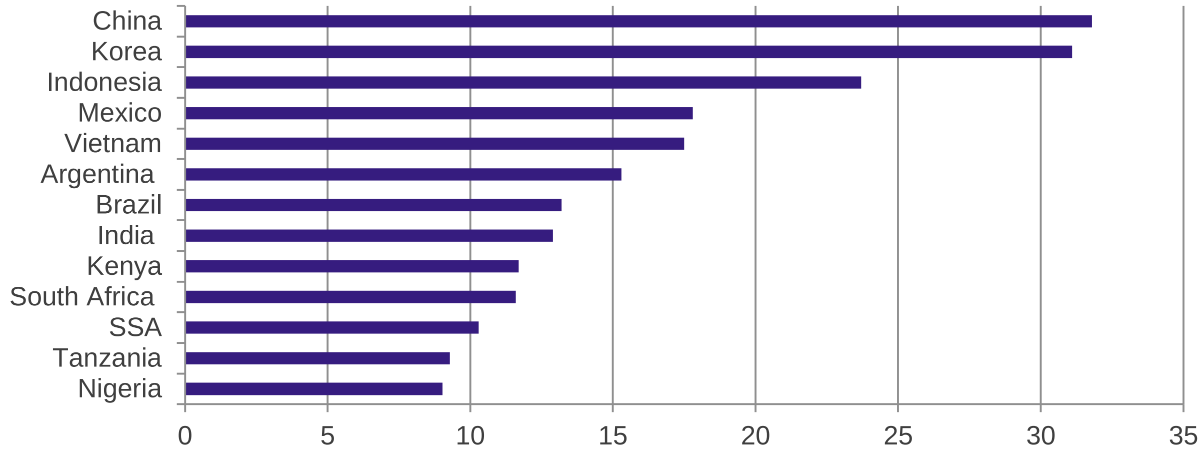
Figure 2 Gross fixed capital formation (% of GDP)



Source: World Development Indicators

Nigeria's growth, moreover, has not been transformative. This perception is affected a little by the rebasing of the GDP series. The pre-rebasing data suggested that over 1990-2010 there had been hardly any structural change. The new estimates of GDP not only make Nigeria Africa's largest economy, but recognise considerably more services sector activities. But even using the rebased data, the share of manufacturing in Nigeria (9%) is still at the bottom of a range of comparator countries (and below the average of sub Saharan Africa at 12%), see Figure 3. Another by-product of the rebasing was to make various metrics look even worse compared to comparator countries as a share of GDP, e.g. on investment, or non-oil government revenue which fell to just 4.5% of GDP.

Figure 3: Share of manufacturing in GDP (2012)



Source: World Development Indicators

Trade (the sum of imports and exports) as a percentage of GDP has declined over the last decade. It is now only 31% of GDP. Trade in services has also declined and was only 5.7% of GDP in 2012. The comparable data for sub-Saharan Africa as a whole are double this percentage. Nearly all of Nigeria's exports are concentrated in crude oil and gas-related products (oil, liquefied gas), dwarfing the few remaining agricultural exports (e.g. cocoa beans, sesame seeds). Many factors hamper Nigeria's exports such as inefficient and weakly governed ports and customs offices. Nigeria's rank on the doing-business indicators in 2014 was 170th out of 189 countries (improving only slightly from 175 in 2013). Nigeria ranks 88th of 194 countries on the trade logistics index. Nigeria is one place below Kenya, but worse than Indonesia, which is ranked 62nd, or Brazil at 74th. Moreover, Nigeria faces a massive decrease in competitiveness as the real effective exchange rate appreciated by 40% over 2009-2014.

We can compare the economic complexity of Nigeria, Indonesia, and African countries over time as measured by Hausmann's economic complexity index (ECI). The ECI measures the level of productive knowledge which is the ability to produce more and more complex products. With a high ECI, a country can more easily produce new (manufactured) products which has been shown to lead to faster and more sustained economic growth. Indonesia has a much higher value of ECI, suggesting that Indonesia has more productive knowledge than Nigeria. This means that Indonesia has more capabilities to produce diverse products than Nigeria. Natural resource (especially oil) endowment may affect countries negatively in terms of achieving economic complexity; that is, there may be a negative relationship between a country's ECI and its oil endowment. Being rich in terms of oil has given the country relatively lower economic complexity. As a further worrying sign, Nigeria has a much lower ECI than even the average for African oil exporters.

Firm-level data suggest that Nigeria's total factor productivity (TFP) appears some 13% lower than that of Kenya. Over 2003/04 to 2009/10 (and using the international measure), poverty has reduced only slightly from 48.3% to 46.1%, masking different levels in rural areas (from 57.4% to 52.9%), urban areas (36.8% to 34.3%) and regional disparities (poverty has fallen rapidly in the South and been stagnant in the South).

To sum up this analysis, Nigeria's economic performance has been poor by most contemporary standards. Its export basket remains very concentrated, lacking diversification into complex products even compared with other African countries. Competitiveness has declined by 40% over the last five years as measured by the real effective exchange rate. The significant number of challenges that Nigeria's current economic model is facing can be summarised as lack of competitiveness and a major lack of production capabilities, including relevant knowledge.

Looking forward

Due recognition of the scale of the required catch-up should only be a starting point for the new administration. There are, moreover, some positive indications to build upon in setting an agenda for accelerated economic transformation. Consider the following:

(1) Foreign direct investment (FDI) from China and elsewhere is growing, albeit from a low base, covering sectors such as oil exploration, telecommunications, mineral exploration, automobile assembly, agriculture, cement, textile, food and beverage, and pharmaceuticals;
(2) the contribution of the manufacturing sector to real GDP has increased considerably with increases in the food, beverage and tobacco sector and textiles, apparel and footwear sector;
(3) despite the unrest in the north-eastern part of the country over the last few years, agricultural output remained strong in 2014;
(4) there are plans to commit $9 billion to a petrochemical industrial complex in the commercial city of Lagos;
(5) Lagos State is an illustrative example of a strong urban growth agglomeration that has produced jobs, generated significant non-oil tax revenues and inclusive growth, bringing millions out of poverty;
(6) a number of industrial estates and small clusters have emerged across the country, e.g. a computer village in Otigba (Lagos); an auto and industrial spare parts fabricator in Nnewi; a leather tannery in Kano; and a footwear, leatherworks, and garment cluster in Aba; and finally
(7) the strong performance of liberalised sectors such as information and communications technology (ICT) as shown in the revisions of the national accounts.

These encouraging signs need to be put together with lessons from the experience of other countries that have achieved a turn-around in economic transformation. One thing that emerges clearly from these experiences is the importance of emphasising global competitiveness, even in a large economy with a growing domestic market. A number of successful economic developers, many in East Asia, have striven to benchmark their performance to global standards, whether by exporting or by opening their national economies to bracing external competition to drive out unproductive firms in favour of productive ones. Notably in Korea, allocating credit selectively to these productive firms played a key role, along with the use of performance criteria to provide time bound incentives.

Successful transformers have usually been able to articulate a clear growth and development strategy so as to create policy consensus and create buy-in from various parts of the economy. Political and social consensus is a necessary prerequisite for successful economic transformation. Building consensus requires a sense among economic actors that they will be able to share in the fruits of progress. For that reason transparency and predictability are vital ingredients for this consensus to emerge. Highly visible progress on specific, relevant aspects of governance (such as management of the oil & gas industry) can do much to rebuild trust and credibly signal to economic and political forces that a new regime is forthcoming. Successful economic transformation policies paired with targeted governance reforms can help a new administration to establish a new course for the future.

Six aspects of policy formulation and implementation appear crucial from international experience: (1) the timing of policy change, (2) the consistency of policy packages, (3) clarity of objectives, (4) gathering support for policy changes, (5) the importance of early wins as well as commitment to long-term objectives, and (6) the importance of monitoring, evaluation, and corrective feedback mechanisms.

A review of economic policy-making in Nigeria suggests that characteristics such as policy consistency, monitoring and learning seem to be lacking in Nigeria's economic policy. With regards to monetary policy, the CBN has enjoyed independence and management autonomy free from political interference, and these played key roles in the moderate success that it has achieved (notably bringing inflation under control). On the other hand, fiscal and sectoral polices are, to a great extent, shaped by the politics and influence (or power) of non-state actors. Coordinating policies among the federating units is also a key challenge as conflict of interest could arise. This affects policy performance and sometimes produces policies that are detrimental to social welfare. Another key feature of Nigeria policy-making process is inconsistency (directly against the key ingredients for successful transformation policy). Despite one political party controlling the Federal Government from the transition to democracy in 1999 to the present, policies and priorities of government have changed with every administration. This is a big issue as it increases the cost of governance and sometimes weakens government effectiveness. Therefore, ensuring policy consistency and managing ‘undue influence’ of politics are crucial to improving policy-making and implementation in Nigeria.

Identifying promising sectors and tacking common constraints for Nigeria’s economic transformation

On what should Nigeria focus on in order to transform, diversify and raise productivity? In this section, we review the main conclusions from using a range of analytical techniques, including revealed comparative advantage (RCA), Hausmann’s product space analysis and Lin’s growth identification and facilitation framework to shed light on this issue, with an emphasis on industrialisation.

We can first examine what Nigeria is already exporting and specialising in, and hence the production capabilities that currently exist and could expand. Data from the UN’s Comtrade database can be used to calculate a revealed comparative advantage index (RCA, also known as the Balassa index)[1]. There are two conclusions from this analysis. First, it suggests that the following products could be targets of diversification: tobacco; crude materials such as rubber, sesame seeds, cotton and fuel wood; food products such as cocoa, nuts and milk; transport equipment such as vessels; manufactured goods such as different types of leather; and some mineral fuels. Second, Nigeria has an RCA greater than one in very few products, suggesting it has low diversity. This is further backed up by calculations using the Hausmann’s complexity index which show that Nigeria is operating at a low level of complexity not only compared with large oil-producers such as Indonesia, but also compared to the average of all Africa countries and even African oil exporters.

A further analysis, the Hausmann product space analysis, suggests a number of promising sectors: chemicals and related products, manufactured goods and machinery and transport equipment. It suggests that Nigeria would benefit from diversifying its production into (1) industrial machinery such as textile yarn machinery, and (2) specific chemicals (e.g. sulphur compounds or epoxide resins). The analysis by Lin and Treichel discuss the following sectors for industrialisation: food processing (including fruit juices, meat and poultry, noodles and spaghetti and tomato paste), construction, motorcycle, tractor and TV assembly, computer assembly, tyre industry, and metal industry (cast irons and manganese steel).

Previous analyses have suggested a range of sectors in different regions. The previous government emphasised the following 13 strategic exports: agro-industrial (palm oil, cocoa, cashew, sugar and rice), mining related products (cement, iron ore/metals; auto parts/cars, aluminium and oil and gas industrial products) and petroleum related products (fertiliser, petrochemical and methanol). This has been further disaggregated by region. In the North-east: agriculture and solid minerals e.g. gypsum, biomass, ethanol, biodiesel, tropical fruits, etc. In the north-west: gum, livestock and meat processing, tanneries, biofuel. In the north-central; fruit processing, cotton, quarries, furniture and minerals, boards, plastic processing, leather goods, garments. In the south-east: palm oil refining and palm tree processing into biomass particle boards, plastic processing, leather goods and garments. In the south-west: manufacturing (especially garments, methanol, etc.), distributive trade, general goods, plastic. And in the south-south: petrochemicals, manufacturing (plastic, fertiliser, and fabrications.), oil services and distributive trade.

The evidence at the firm level shows that the electronics and non-metallic minerals sectors already have a relatively high level of total factor productivity in Nigeria and compared with Kenya and Indonesia.

[1] This data is broken down by Standard Industrial Trade Classification (SITC) 4-digit section (one of 1028 products). The share of each country’s exports in a section is calculated as a percentage of the country’s total exports in SITC 4-digit section, and these shares are then expressed as a ratio of the analogous shares of world exports. ‘World’ is defined as Comtrade’s ‘All countries’ aggregate (which represents the sum of the data reported by all countries in any given year).

Moreover, there are already some clusters building up around (1) a computer village in Otigba (Lagos), (2) auto and industrial spare parts fabricators in Nnewi, (3) leather tannery in Kano, and (4) footwear, leatherworks, and garment cluster in Aba.

In developing policies for particular promising sectors, the new government can draw on a large body of accumulated knowledge about typical constraints requiring priority action. There are a number of well-known general constraints to achieving further growth, export diversification and economic transformation. There seems a reasonable consensus around the general constraints to growth (applicable across sectors) which include: (1) targeted and core infrastructure (in power, integrated transport network, aviation); (2) access to finance, particularly for small businesses; (3) reduced business environment costs that can encourage high value-chain sectors (e.g. reducing multiple taxation, encouraging formal land titling); (4) lower import protection and lower trade costs that will reduce input costs; and (5) skills building, particularly through entrepreneurial and management training, and human capital development (health and education) generally.

Many decades of experience in promoting industrialisation around the world clearly show that there are certain types of industrial policies to avoid, i.e. those that pick and choose particular firms rather create the broad conditions for winners in a sector or larger part of the economy, those that are not time bound and do not require improved performance, those that heavily distort private investment incentives, or involve Government getting directly involved with investors, and those that are not implemented consistently over time. Instead, the government can add most value by providing a predictable and conducive business environment for investment, for both national and foreign, small and large, North and South. Targeting activities only works if this is governed by effective state-business relations that involve adequate capacity in both public and private sectors, transparent and reciprocal relationships and absence of collusive behaviour.

Final words: imagining feasible economic transformation pathways for Nigeria

This briefing has argued three things. First, focusing on the past, Nigeria has lost competitiveness in manufacturing over the past decade and has failed to develop much productive knowledge, despite the potential to do so on the basis of a decade of significant oil revenues. Nigeria today is far from the efficiency frontier in manufacturing and certainly below par in many service industries. Second, looking at international experience in middle-income countries, there are strong reasons for emphasising global competitiveness even in a large economy with a growing domestic market. Of course there are human capital constraints to cope with; however, that said, Nigeria’s national goals should be first to be the most efficient producer on the continent, and second to narrow the productivity gap versus other emerging market economies. Third, looking to the future under a new government, the possible entry-points for improving the pattern and quality of economic growth in Nigeria are numerous and varied. A good range of sectors and products appear economically promising on the basis of any one of three types of rigorous analytical methods (Revealed Comparative Advantage, Product Space Analysis, and the Growth Identification and Facilitation Framework).

To be sure, based on the international experience, the quality of policy design and coordination required to realise this potential and put economic transformation on a firm footing is extremely demanding. Recalling the findings of the Growth Commission, successful economic transformation, even within a single sector, involves getting many things right, in a coordinated way. And the quality of the policy formulation, and especially policy implementation, that this calls for is high. The policy-process requirements that have been rarely achieved even in moderately successful middle-income economies (for example, in Latin America) include: concerted monetary, trade and subsidy measures; pre-announced and predictable industrial policies; careful management of the incentives of ‘winners’ and ‘losers’; and intensive monitoring against fixed targets and goals. Without these measures, industrial policies tend towards the strengthening of firms whose profitability depends on subsidies and a domestic market niche, with international competiveness becoming progressively harder to achieve.

Thus, business as usual will not be enough. What is needed in Nigeria is bold and imaginative thinking about technically sound and politically feasible first steps that set the economy on a pathway towards economic transformation. In the immediate future this may mean being selective: demonstrating what policy for economic transformation looks like by concentrating on a limited number of promising sectors and taking an entrepreneurial, learning by doing, approach to what is required. This should be approached as a learning process. The necessary realism about political and economic constraints and opportunities will not be achieved by a one-off analysis that identifies the main stakeholders and captures the current best guesses of policy makers about their interests and likely points of view. Those leading reforms must have the interest, capability and freedom of action to try out a few avenues towards desirable policy reforms and draw lessons in a tough-minded way before getting fully committed, so that their best guesses become progressively better informed and more refined.

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