TRADE LIBERALIZATION, EXPORT DEPENDENCE AND DIVERSIFICATION OF EXPORTS IN NIGERIA

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ABSTRACT

Nigerian economy over the past few decades has adopted more liberal trade regimes and increased its dependence on trade in primary products without any significant progress in terms of diversifying their export base. Studies have shown that exports concentration on products, sectors, and markets with a limited scope to improve productivity and product quality may result in low growth. Absence of diversification increases vulnerability to external shocks which can impact negatively on exports earnings. This paper examines the impact of trade liberalization and export dependence on export diversification in Nigeria from 1980 to 2018. We employed short-run ECM technique to account for possible short-run disequilibrium in the relationship. We found, among other things, that trade liberalization has negative but insignificant impact on Export Diversification, Export Dependence has positive but insignificant impact on EXD in Nigeria. Foreign direct investment, gross national expenditure and financial development exact positive and significant impacts on export diversification in Nigeria. Specifically, it found that a 1% point increase in FDI would increase EXD by approximately 30%, while a 1% increase in gross national expenditure would, in the short-run, significantly increase exchange rate diversification by 18%, other factors remaining constant. On this basis, the paper recommends that for exports of products to be diversified in Nigeria, the free trade zone policy needs to be strengthened by the government to help open up more operational areas such as the Calabar and Lagos free trade zones.

KEYWORDS: Trade liberalization, export dependence, diversification of exports, Nigeria.

1. INTRODUCTION

Trade liberalization, export dependence and diversification of exports have been a raging issue in Nigeria right from the period of independence till date as a result of over concentration or oil export at the expense of other critical revenue generating sectors such as Agriculture, mining, and solid minerals. In an attempt to minimize this over dependence on oil export, export diversification becomes an easy route for the Nigerian government to pursue and implement certain trade policies such as export promotion strategies adopted in 1981, formulation and adoption of trade liberalization policy of 1986, the constitution of the Nigerian import and export banks including various trade policies that are failure towards advancing trade and for export diversification. It is therefore pertinent to realize that the rationale behind these policies in to diversify the economy and also to achieve economic prosperity

Nigerian economy has grossly underperformed relative to its economic endowment and her peer nations as a result of over concentration on oil export at the expense of other natural endowments With about 37 solid minerals types and a population estimates of over 180 million people, one of the largest gas and oil reserves in the world, the economic performance of the country is rather weak when compared to the emerging Asian countries such as Thailand, Malaysia, China, India and Indonesia and even Brazil. These countries had by far lagged behind Nigeria or at par with Nigeria in terms of GDP per capital in 1970s, but later they were better able to transform their economies to emerge as major players on the global economic arena through trade liberalization and export diversification.. In 1970, for instance, Nigeria had a GDP per capital of US$233.35 and was ranked 88th in the world, when China was ranked 114th with a GDP per capital of US$111.82 (Sanusi2010).This disparity continued up till date and many scholars have attributed it to the bold step these Asian tigers took to increase their export based and diversified their economy. Today, China occupied an enviable position even as the second largest economy after the United State of America, largely owing to her self-esteemed trade position and export diversification.

It is therefore disheartening that all these avalanche of interventions have not yielded the desired result because the Nigerian economy has depended majorly on oil export with little contributions from the non-oil sectors, hence, the need for a complete and holistic export diversification. Statistics has shown that the share of crude oil export to the overall export capacity of Nigeria has continued to rise from 2.6% in 1960 to about 98% in 2000 before declaring to 92.5% in 2015 and has continued to fluctuate between that up to the year 2018. However, while the contribution of the non-oil sector which was about 97.4% in 1960 declined abysmally to 1.2% in the year 2000 before marginally increasing to 7.5% in 2015.

The import of the above situation is that trade liberalization, export dependence and diversification of exports is not only a necessary condition to achieve economic growth, it is also a sufficient condition to opening up the country's exports for global competition and accessibility and it would help in achieving stable economic growth, stability in foreign exchange earnings and withstanding the volatility in global oil prices and fluctuations in exchange rate.

Although there is plethora of studies on how trade policies affect export diversification, none has actually measured these effects using parametric and non-parametric procedures in their estimation and analysis.

In the light of the above, the paper intends to find out the effect of trade liberalization policy on export diversification in Nigeria and the impact of trade openness on export dependence and diversification in Nigeria

Conceptual Clarification

Trade liberalization: Trade liberalization is a policy by which a government does not discriminate against imports or interferes with exports by applying tariffs (to imports) or subsidies (to exports) or quotas (Hamad, Burhan & Stabua, 2014). It involves removing barriers to trade between

different countries and encouraging free trade. Trade liberalization involves reducing tariffs and eliminating quota. Putting succinctly, trade liberalization is an economic policy by which all forms of trade policy that inhibits free flow of trade between countries are minimized or removed for effective and efficient exchange of goods and services.
Trade liberalization has some advantages which include: comparative advantage, increased competition, economies of scale and inward investment. It also has problems like structural unemployment, environmental costs, etc. The result of trade liberalization is free trade and removal of all sorts of trade restrictions. It has therefore been a near consensus among economics scholars that the benefits of trade liberalization are the same as those of free trade (Arsalan, 2010). Trade liberalization policies open up the opportunity for countries' economies to achieve growth and foster overall development (Manni & Afzal, 2012); and increases capital inflows which takes several forms like Foreign Direct Investment which is an important source of capital inflow that fills the investment gap in the economy (Qayyum, Younas, & Bashir, 2018).

Trade Dependence: Trade dependence is an economic policy in which the bulk of a country's international trade is tilted towards exportation of goods and services. A trade dependent country relies heavily on international trade that constitutes a large percentage of its economy. This concept is basically hinged on the fact that countries that are endowed with some primary resources should improve its value in order to compete favourably in a highly competitive and globalised market in order to attract foreign acceptability. However, some scholars have raised some apprehensions about the harmful effects of high dependence on primary commodity export. The fears are anchored on the assumptions that primary commodity exporters are affected by the negative outlook in terms of their balance of trade and that primary exporters may be prone to high price volatility and low productivity growth. Presbsich-Singer (1950)

Export Diversification: Export diversification is the process of increasing the variety of goods and service exported to other countries or trading partners. It is also the breaking grounds on new goods that are of higher value and quality, that can also command new market and compete globally in the international commodity markets. Export diversification is an economic policy that is anchored on reducing the over reliance of few products in an international trade .In other words, it discourages countries from being known as a mono economy. The concept of economic diversification has three key basis viz a viz (i) Geographic diversification which implies expanding the range of markets into which existing products are sold. (ii) Upgrading the quality of existing products including agricultural products and (iii) Taking the advantages of the opportunities to increase exports of services.
Export diversification is the process of shifting an economy away from a single export source toward multiple sources from a growing range of sectors and markets. Traditionally, it has been applied as a strategy to encourage positive economic growth and development.

2. REVIEW OF LITERATURE

2.1 Theoretical Literature

There are avalanche of literature on trade liberalization, dependence and export diversification on cross country analysis with much emphasis on Nigeria considering our peculiarities in terms of lopsidedness in resource endowment. This paper contributes to the existing body of knowledge by using parametric and non-parametric techniques to measure the nexus between trade liberalization, dependence and export diversification. It is a remarkable deviation from previous studies that were merely focused on the impact of trade liberalization and economic growth in Nigeria. Nevertheless, some works such as Yi & Meng, (2018), Barone & Cingano, (2011) Javorcik & Li,(2013) Head et al.,(2014), Bas, (2014) Hoekman & Shepherd, (2017) Shi.(2016) Li & Zhang, (2018) Sun et al., 2018) either focus on the study of the impacts of the goods trade on liberalization or the services trade liberalization in the home country

Lopresti (2016) finds the heterogeneous reactions of the firms with different export ratios in response to the trade liberalization. The firms who pursue relatively high proportion of international sales will increase their product scopes, while the firms with low international participation ratio will reduce their product scopes. Li and Zhang (2018)posit that the services liberalization encourages firms' productivity through reduction in the price level of the foreign services and the market-entry cost for the exporting firms, while the FDI in the services sector has technological spillovers on the local firms. For example, the domestic firms can leverage on the sophisticated management skills and production technologies from the foreign firms, and then increase their innovation, management, production, and export performances.

Nicita and Rollo (2015) opined that export industries in low-income countries tend to be small in scale and relatively unsophisticated, and they often specialize in products that cannot be produced easily or competitively in the developed world hence the importance of diversifying and upgrading their economic structures and exports baskets. Fonchamnyo and Akame (2017) captured the impact of trade openness and not trade policy on exports diversification in SSA countries. The paper finds that in SSA countries, trade openness is a major determinant of export diversification, value added in agriculture and manufacturing, and FDI. Also, foreign aid, official exchange rates, and gross domestic investment promoted export diversification in selected economies.

2.2 Empirical Literature

Longmore, Jaupart and Cazorla (2014) examined the determinants of economic diversification in Trinidad and Tobago over the period 1980 to 2010 using a dynamic panel GMM technique for a set of 183 countries, the study found that openness to foreign direct investment inflows is the most fundamental determinants of economic diversification in Trinidad and Tobago. The study recommended that greater openness to foreign direct investment and improvements in ease of doing business are strategic policies that can be implemented to expand the range of activities of the country's economic structure.

Haouas and Heshmati (2014) assessed the role of economic diversification on the UAE economy. The findings of the study supported the fact that the UAE is facing an oil curse. This was evident by the declining levels of total factor productivity, volatile economic growth, negative returns on investment, and over reliance of domestic labor force on government's employment. The study also observed in recent times that the UAE economy has recorded impressive attempt at diversifying its economy. Thus, the study recommended that greater efforts were needed to stimulate the diversification of the production base by encouraging increased domestic, especially private investment. The study also stressed that well-targeted policies should be adopted to accelerate reform and facilitate the involvement of the private sector in the economy.

Aditya and Acharyya (2015) examined the relationship between trade liberation and export diversification. The study basically assessed the implications of tariff reductions for diversification of export basket across and within industries measured in terms of larger sets of homogeneous goods and horizontally-differentiated varieties in two country world. The outcome of the study indicated that unilateral tariff reduction is capable of making the liberalizing country's exports diversified both across and within sectors whereas the trading partner may experience across-sector diversification. Under bilateral tariff reduction exports of larger number of differentiated varieties may be realized only for the country in whose favour the ratio of national wages move.

3. METHODOLOGY

Unarguably, the benefits of trade liberalization and export diversification have been exhaustively debated upon according to relevant literature. There is no common theoretical framework that is most suited in explaining the driving forces of trade liberalization, export dependence and export diversification. However, going by the review of the extant theoretical literature on trade liberalization and export diversification which represents divergent views, this study employed the Prebisch (1950) and Singer (1950) export diversification theory. The theory argued that developing countries pose to increase their exporting products variety due to low income elasticity of demand for the primary products. Also, export diversification helps the emerging economies to reduce the risk of price instabilities, term of trade, and shocks in commodity. Scholars such as Cooper and Brainard (1968), Carrere, Strauss-Kahn and Cadot (2007) and Hesse (2008) have also laid credence to the Prebisch-Singer hypothesis, stressing that diversification from primary products is desirable for an emerging economy like Nigeria (Shabana & Zafar, 2014)

Model Specification

Based on the above hypothesis, this paper specifies a model to estimate the nexus among trade liberalization, export dependent and diversification in Nigeria, in the following function.

EXD = f(TRB, XPD, FDI,GXP, EXV, FSD) -- (1)

EXD = export diversification measured by export diversification index

TRB = trade liberalization proxy by trade as percentage of GDP,

XPD = export dependence measured by the ratio of export amount to GDP.

FDI = foreign direct investment

GXP = gross national expenditure (% GDP)

EXV = exchange rate volatility

FSD = Financial development is measured by the ratio of credit to the private sector to GDP

Equation (1) can be transform into an econometric model in the following format:

$$EXD_t = \beta_0 + \beta_1 TRB_t + \beta_2 XPD_t + \beta_3 FDI_t + \beta_4 GXP_t + \beta_5 EXV_t + \beta_6 FSD + \mu_t \text{ ---- (2)}$$

Trade liberalization and export dependence are expected to promote export diversification through an increase in the number of exporters and improves export opportunities in well diversified sectors. The influence of the financial development on export diversification is ambiguous. It could be positive, when financial sector development reduces liquidity constraints by enhancing the level of investment by exporters which can facilitate export diversification (Agosin et al, 2011; Melitz, 2003). It could as well be negative, when financial development constraints export diversification because investors do not want to take risk on untried ventures, and they may decide to concentrate their financial resources on existing activities where the economy has comparative advantage (Manova, 2008; Chaney, 2005). Foreign direct investment is expected to increase export diversification when the diversification is centred on the non-oil sector of the economy. Public expenditure is expected to increase export diversification through infrastructural development which enhances investment level while exchange rate volatility may retards export diversification because it discourages investment.

Data/Data Transformation

Data on export diversification is sourced from International Monetary Fund (IMF) database. Data on other variables: export dependence (xpd); financial development (fsd); foreign direct investment (fdi), gross national expenditure (gxp) and exchange rate volatility (exv) were sourced from the World Bank Development Indicator (2018). Exchange rate volatility is computed using E-GARCH volatility model. The EGARCH model has the capacity of capturing of asymmetric effects and its non imposition of non-negative constrain on the parameters (Jamil, Streissler & Kunst, 2012).

Export diversification is measured by export diversification index. Trade liberalization policy is measured by total trade as a percentage of GDP, the higher the percentage the more liberalized the economy. Export dependence is measured by the ratio of export amount to GDP. It measures the ratio of the total amount of foreign trade of a country to its gross domestic product (GDP). It captures the degree of dependence of a country's economy on the international market. The ratio is used to measure the degree of dependence of a country's economy on the international market. Foreign trade is divided into export and import. Correspondingly, trade dependence ratio can be divided into two categories: degree of dependence upon export, i.e. the ratio of export amount to GDP; and degree of dependence upon import, i.e. the ratio of import amount to GDP. In practical work people tend to pay greater attention to export dependence ratio compared to trade dependence ratio.

4. RESULTS AND DISCUSSION

The result starts with the unit root test conducted to ascertain the stationary status of the variables. In 5% level of significance the dependent variable, export diversification (EXD),foreign direct investment (FDI) and gross national expenditure (GXP)are not integrated, I(0), as they show significance in level form. While variables such as the trade liberalization (TRB), export dependence (XPD), exchange rate volatility (EXV), and Financial development (FSD) are integrated of order one, i.e. I(1).

Unit Root Analysis using Augmented Dicky-Fuller test

	ADF level		ADF 1st Difference		Trend	Integration order
Variable	**t-Stat**	**5% Cri. Value**	**t-Stat**	**5% Cri. Value**		
EXD	-3.654646	-3.536601	-2.850322	-3.225334	Yes	I(0)
TRB	-1.867505	-2.941145	-8.424081	-2.943427	No	I(1)
XPD	-2.896515	-2.941145	-8.401760	-2.943427	No	I(1)
FDI	-3.639852	-2.941145	-3.637029	-3.533083	No	I(0)
GXP	-4.574569	-2.943427	-9.006943	-2.945842	No	I(0)
EXV	-3.155586	-3.536601	-4.563862	-2.943427	Yes	I(1)
FSD	-2.900328	-2.941145	-5.579750	-2.943427	No	I(1)

The pattern of the above unit root result is suggestive of possible long-run relationship in the model. Thus, a cointegration analysis is conducted to ascertain the number of cointegrating vector in the model. In doing this, two statistics were computed, the tau and z statistics.

Table 4.2: Cointegration Result

Dependent	tau-statistic	Prob.*	z-statistic	Prob.*
EXD	-3.932815	0.4756	-36.89773	0.0189
TRB	-2.278955	0.9777	-14.32140	0.8837
XPD	-3.726494	0.5692	-76.11133	0.0000
FDI	-4.250396	0.3391	-24.59329	0.3461
GXP	-3.680222	0.5891	-22.27195	0.4739
EXV	-3.952422	0.4669	-33.94510	0.0458
FSD	-4.088170	0.4076	-35.17081	0.0322

*MacKinnon (1996) p-values.

The tau-statistic result indicates no cointegration among the variables, while the z-statistic shows that at least four (4) cointegrating equations exist in the model. With the above result an Error Correction Model (ECM) is employed to account for the speed of adjustment that emanated from short-run disequilibrium. Table 4.3 presents the result of the impact of trade liberalization and export dependence on diversification of export in Nigeria.

Table 4.3: Short-run ECM result on Trade liberalization – Export dependence and Diversification nexus

Dep Var: Export Diversification (EXD); R^2= 0.877; DW-stat = 2.27		
Variable	**B**	**t-statistic (Prob)**
TRB	-0.283864	-0.963678 (0.3429)
XPD	0.496960	1.629755 (0.1136)
FDI	-0.297212	-2.551921*** (0.0160)
GXP	0.183254	2.580141*** (0.0141)
EXV	-0.338986	-10.97753*** (0.0000)
FSD	0.469072	2.328553** (0.0268)
ECM(-1)	-0.783253	-6.201874*** (0.0000)
C	6.252842	1.629692 (0.1136)

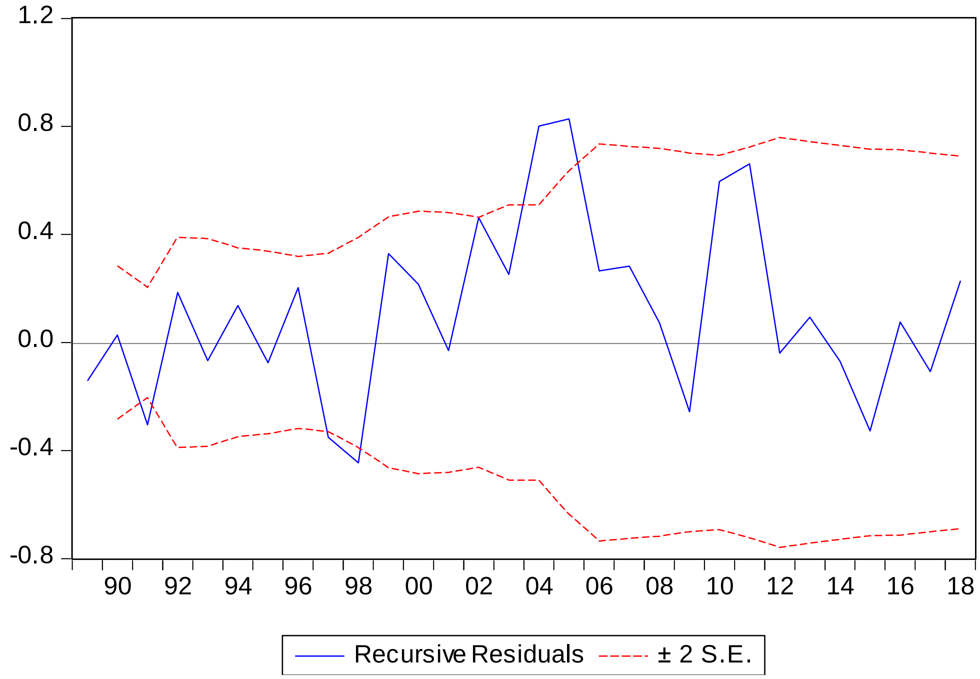
Table 4.3 result shows that trade liberalization (TRB) has negative but insignificant impact on Export Diversification (EXD), while Export Dependence (XPD) has insignificant positive impact on EXD in Nigeria. It indicates that EXD exhibits short-run negative linear insignificant function of TRD. It shows that a 1% point increase in TRB would insignificantly decrease EXD by 28%, while a 1% point increase in XPD would insignificantly increase EXD by 49%, holding other variables constant. Unlike trade liberalization and export dependence variables, foreign direct investment (FDI), gross national expenditure (GXP) and financial development (FSD) have

positive and significant impacts on export diversification in Nigeria. Specifically, the result shows that a 1% point increase in FDI would increase EXD by approximately 30%, while a 1% increase in GXP would, in the short-run, significantly increase EXD by 18%, other factors remaining constant. On the other hand, a 1% point increase in financial development, *ceteris paribus*, would, in the short-run, increase EXD by 46%. Also shown in the result is that export diversification exhibits negative linear function of exchange rate volatility (EXV), in the short-run. It indicates that a 1% increase in exchange rate volatility would in the short-run decrease export diversification index by 33%, provided other factors are kept fixed.

The above finding is collaborated by a number of studies. For example, Shabana and Zafar (2014) in a study to examine the determinants of export diversification for selected ASEAN and SAARC member countries for the time period 1986 to 2012 found that foreign direct investment and financial sector development exact positive-significant impact on export diversification in both ASEAN and SAARC regions. Nwosa, (2018) investigated the relationship between trade policy and export diversification in Nigeria and found that trade liberalization and trade openness had insignificant impact on export diversification while, contrary to the finding in the current paper, foreign direct investment had negative and significant effect on export diversification in Nigeria in Nwosa's study.

The finding in this paper that foreign direct investment inhibits export diversification is in line with Longmore et al. (2014) and Nwosa (2018) that the lopsidedness in the inflow of foreign direct investment which has over the years concentrated on the oil sector at the expense of the non-oil sector. The coefficient of the speed of adjustment parameter (the error correction term) is negatively signed (-0.78) and statistically significant which confirmed to expectation. The implication is that the model corrects its short-run disequilibrium by about 78 percent speed of adjustment in order to return to the long-run equilibrium. This implies a short-run adjustment speed, that is, within 18 months of the short-run disequilibrium in export diversification as a result of shocks in its determinants will quickly correct back to equilibrium, within the same time frame other factors remaining constant.

To evaluate the robustness of the estimated model, a Recursive Residual stability test was conducted on the residuals of the regression. The stability tests showed that the model was adequately specified and that the parameters of the models did not suffer from any structural instability over the period of study.



This is because the Recursive Residual plot is within the bounded line of five percent significant level as seen above figure.

5. Conclusion and Policy Recommendations

This paper investigated the impact of trade liberalization and export dependence on export diversification in Nigeria over the period 1980 to 2018, with a conclusion that both trade liberalization and export dependence measures have no significant effect on export diversification in Nigeria. While trade liberalization has negative insignificant effect, export dependence exact positive but insignificant impact on export diversification. In the light of this, the following recommendations were made:

1. The free trade zone policy should be strengthening by the government to help open up more operational areas such as the Calabar and Lagos free trade zones. This can be achieved by improving infrastructural development in these areas, such as good road network,

2 Stable power supply, and adequate security of lives and properties.

3. Government needs to, dramatically, reduced de-emphasize the dependency on oil and encourage other primary sectors of the economy. This is because the continuous emphasis on oil will incessantly decline the drive of the government at diversifying the export base of the economy.

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