

# Empirical Analysis of The Growth Effects of International Trade in Nigeria

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## **ABSTRACT**

*This role of foreign trade in driving growth in the domestic economy and boosting the potential of a country to foreign exchange earnings has remained a subject of interest in economic literature, thus provoking investigation into the claim that international trade is growth-enhancing. This study centred on the impact of foreign trade on economic growth. The specific objectives of this study are to explore the effects of net export, exchange rate and government capital expenditure on economic growth. This study covered a period of 35 years (1980-2015) and the source of data for the variables is the Central Bank of Nigeria Statistical Bulletin. The error correction model (ECM) was utilized as a technique for data analysis. The Phillips-Perron unit root test shows that the variables are stationary upon first differencing. Thus, the series are integrated of order zero. The Johansen cointegration test result indicates that the variables are cointegrated. Therefore, this reveals that the variables have a long-run relationship. The cointegrating regression result shows that net export has a significant positive impact on economic growth. The exchange rate on the other hand is found to significantly and negatively influence economic growth. The long-run impact of government capital expenditure on economic growth is negative and insignificant. The Wald test for coefficient restrictions shows that net export, exchange rate and government capital expenditure are statistically significant in explaining changes in economic growth. Based on the findings, it is recommended that government should adopt trade policies that promote export and reduce the incidence of importing competing goods to ensure that Nigeria optimizes the benefits that foreign trade creates.*

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**Keywords:** *International trade, net export, exchange rate, capital expenditure and economic growth*

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## **1. Introduction**

The birth of foreign trade arises from the fact that no entity or nation can manufacture its needs efficiently. It necessitates the purchases and sale of goods and services between two or more countries. It endears nations to produce efficiently their well-endowed products and purchase those products that they are less endowed in producing (Tom-Ekine, 2013).

Arising from the above, the consequence of foreign trade towards stimulating economic growth and development has aroused the interest of a lot of economists, decision makers and policy

makers. It is evident in some literature that foreign trade propels economic growth. It generates locally and internationally professions prospects, upsurges foreign currency earnings, promotes favourable balance of payments position, government revenues are robust via taxes, levies and tariffs, enlarges a country's consumption capacities, increases world market and gives access to scarce resource.

Economic growth is regarded as the means, while economic development is the end. An economy will have to experience a continuous increase in their per capital income (means) in order to achieve or provide their basic needs (ends). Friedman (1972) argued that growth is an expansion of the system in one or more dimensions in its configuration and development as an innovative process leading to the structural transformation of the social system.

The emphasis on foreign trade as a driver of economic growth stems from the classical and neoclassical theories of international trade. The successful experience of East Asia, Taiwan, South Korea and China reveals the strategic effect of trade and development (Todaro and Smith, 2011).

Nigeria partakes actively in foreign trade. Englama et al (2010) argued that the country's vigorous export products were groundnuts, cocoa beans, palm oil cotton and rubber between 1950 and 1960. The country discovered crude oil in profit-making quantity in 1956 in Oloibiri in the present-day Bayelsa state. Subsequently, crude oil became the major export commodities, with a gradual neglect to the agricultural sector of the economy.

The net effect of the discovery of crude oil in Nigeria is that the foreign currency earnings from agriculture sector began to decline. Soderbom and Teal (2001) debated that real per capita income contracted to about 30 percent in 1983 compared to what it was during the oil price boom.

Today, Nigeria is the 6<sup>th</sup> largest producer of crude oil in the Organization of Petroleum Exporting Countries OPEC (OPEC, 2015). The endowment of crude oil to Nigeria has failed to impact positively to the standard of living of her citizens, which is very sadden to reckon. Muritala (2012) stressed that due to the excess production of crude oil in the world market in 1981. The price of crude oil in the World market contracted significantly from \$40 per barrel in 1981 to \$29 per barrel in 1983, subsequently in 1986 it dropped to \$14.85 per barrel. History is replaying itself from 2014 to 2016; the World oil price has dropped drastically as supply exceeds its demand with the U.S and Canada increasing their production of Shale oil. While China, whose growth and expansion created a high demand for oil in the first decade of the new millennium, began to experience slow economic growth after 2010 ( Greg DePersio, 2014).

The oil price raised to \$150 per barrel in 2008, nosedived to \$107.89 in June 2014, \$59.46 in Dec 2014 and by January 2016, crude oil was below \$30 per barrel. This decline in crude oil price also affected the country's foreign reserves, which stood at \$62,081.66 billion in 2008, reduced to \$34.47 billion on 31<sup>st</sup> of Dec,2014 and as of January 2016 it crashed to 28.2 billion (Premium Times, 2016). The above play of events indicates that Nigeria's gain from foreign trade has been trifling. Probably, because the country's major export commodity is crude oil. Little wonder, Usman (2011), argued that foreign trade has made Nigeria an import-dependent economy and has not enthused economic growth, because her economy still experiences economic instability. In light of the above discussions, this study sets to shed more light on the consequence of foreign trade on Nigeria's economic growth between 1980 and 2015.

## **2. Literature Review**

### **2.1 Review of Theoretical Literature**

#### **2.1.1 Mercantile Trade Theory**

The development of the mercantilist theory is closely related to the work of Mun and Misselden (1620). Notably, Steuarts' (1767) publication of 'Principles of Political Economy served as a building block for the mercantilist theory. Jean Baptist Colbert and Thomas Hobbies are known scholars of mercantilism. The theory was prevalent among nations between 1600 and 1800. The mercantilist argued that for a nation to be powerful and successful in foreign trade, the county should export more than its import. They do not support the idea of free trade, they advocated for controlled, regulated and restricted trade. They cited that commercial policies such as tariffs, quota, import substitutions e.t.c. should be in place to control import, stimulate export and maintains a country's balance of payment position.

The mercantilism is quite an old theory but it is still relevant in our modern politics and trade policies of many countries, with its diverse features. They are nationalist, considering the welfare of the nation as paramount by developing a strong military strength and protecting their treasury and territory from invasion. In today's world, this ideology is very relevant as no benefit of trade can be enjoyed in an unsecured environment.

The major setbacks of mercantilism are the believed that the wealth of the world is fixed or limited that nations cannot benefit from foreign trade simultaneously, that a country will have to gain at the expense of the other. In the 18<sup>th</sup> century, the mercantilist was under serious critiques. David Hume analysis the favourable balance of payment as short run that could be overtake as the other trading partners could retaliate to their commercial policies. They are also attacked on their view on the world static economy. In the midst of these critic's, their theory is still a float, the new mercantilist argued that employment is beneficial than holding of gold. They cited clearly that export are beneficial as it creates employment locally, while imports are detrimental as jobs are created in foreign countries.

#### **2.1.2 Absolute Advantage Theory**

Adam Smith a Scottish economist initiated the theory of absolute advantage, in his prominent book "Wealth of the Nation" in 1776. He is a critic of mercantilism, he argued in favour of the free trade policy of trade as the best to promote world trade and encourage specialization in the production of goods and services that a country can produce more efficiently and import the goods and services that they produced less efficiently. Smith argued that specialization in factors of production would result in an increase in the world output and benefits shared among trading partners. Therefore, nations can benefit from trade simultaneously, not at the expense of other nations as argued by the mercantilist.

This theory emphasized that a country should specialize in the production of export commodities in which it has lower cost advantages and import commodities in which it has higher cost disadvantages. The major drawback of the Absolute Advantage Theory is that the theory was silent on the mechanism the world gain would be distributed among residents in each country and between trading partners. The model did not explain what happens if one country has shifted all

its labour into the industry it has an absolute advantage, while the other country still produces both products. It also failed to analyze a situation where a country has a comparative advantage in the production of two goods.

## 2.2 Empirical Literature

Sun and Heshmati (2010) examined the effects of international trade on economic growth in China between 2002 and 2007. The study employed econometric and non – parametric methods to analyze the panel data sourced from 31 provinces on growth dynamics in China. The result shows that the involvement of China in international trade stimulates its national economic growth. The recommendation was that China should adopt an outward policy to promote export and high-tech trade. Similarly, Haq and Luqman (2014) surveyed international trade contribution to economic growth through human capital accumulation. The study employed the Neo-Classical growth theory and econometrics to analysis the panel data sourced from nine Asian countries, over the period 1972-2012. The result proved that international trade stimulates economic growth through human capital accumulation. Recommendations are government of developing countries should liberalize technology imports and create a mechanism to absorb these technologies for sustained economic growth.

Soi, et al (2013) assessed the impact of international trade on economic growth of Kenya from 1960 – 2010. A multiple linear regression model and Barro growth model was used to estimate the existing relationship between variables like exchange rate, inflation and final government consumption on GDP. The result is that exchange rate has no effect on GDP growth rate, while inflations have negative and significant effect on GDP growth rate. Final government consumption has a positive effect on GDP growth rate in Kenya. The study recommended policy makers to focus on policies promoting exports, price stability and government expenditure on development projects so as to encourage economic growth in Kenya.

Omoju and Adesanya (2012) examined the impact of trade on economic growth in Nigeria from 1980 to 2010. This study employed the ordinary least square technic to estimate the relationship between variables like ,FDI, exchange rate, trade ,government expenditure and GDP. The result shows that the entire variable has a positive significant on GDP and recommended exchange rate stability, including government to create conducive environment for trade to thrive. In a related study, Nageri, et al (2013) appraised growth through trade: Nigeria as a case study. This study employed the OLS regression method to analysis data sourced from CBN, NBS and UNCTAD for the period 1975 to 2012. The result indicates that total trade, FDI, exchange rate and degree of openness are statistically significant to growth. FDI and exchange rate contribute positively to growth while degree of openness is negatively contributing to growth. Recommendations are government should reappraise its trade policy and diversify the economy.

Adeleye, et al (2015) examined the impact of international trade on economic growth in Nigeria for the period of 1988 to 2012. The study applied the regression analysis while using co-integration and error correction modelling techniques to determine the long-run relationship between the variables like GDP, BOT, Total import, Total export and BOP. The result shows that only total export is positive and significant while the others are insignificant. Recommendations are government should urgently diversify the economy and boost non-oil export.

Yakubu and Akanagbu (2015) empirically examined the impact of international trade on economic growth in Nigeria for the period 1981 - 2012. The ordinary least square technique was employed to analyze the data extracted from the World Bank and Central Bank of Nigeria Statistical Bulletins. The result shows that all the variables except interest rate were statistically significant. The study recommended that policymakers should adopt policies on trade liberalization such as the reduction of tariffs, or eliminating quotas that will enable the economy to grow at spectacular rates.

### 3. Methodology

#### 3.1 Model Specification

The model utilized by this study is unarguably an improvement to the empirical fronts of Soi et al. (2013) and Omoju and Adesanya (2012) given that net export and government capital expenditure were included among the explanatory variables. On the basis of the behavior form, net export and government capital expenditure are expected to have positive effects on economic growth while the increase in the exchange rate is expected to contract economic growth. Based on the above discussion, the functional specification of this model is as follows.

$$RGDP = f(NEX, EXR, GEC) \quad (1)$$

The econometric representation of the model in equation (1) takes the form below.

$$\ln RGDP_t = a_0 + a_1 NEX_t + a_2 \ln EXR_t + a_3 \ln GEC_t + \mu_t \quad (2)$$

Where RGDP = Real Gross Domestic Product

NEX = Net Export

EXR = Exchange Rate

GEC = Government Expenditure on Capital goods

$a_0$  = Intercept,  $a_1$ ,  $a_2$ ,  $a_3$  are Parameter estimates of the explanatory variables,  $\ln$  = natural log notation and  $\mu$  = error term

#### 3.2 Method of Data Analysis

This relied on the descriptive statistics and Error Correction Model (ECM) for estimating the short-run behaviour of the regressors and the speed at which short-run deviations are reconciled to incorporate adjustments in the short term to stable state equilibrium in the long run. Notably, this study allows sufficient lag length in the ECM to adequately integrate the data-generating process in the general to the specific approach of modelling. Additionally, the pre-estimation tests precede the estimation of the regression models while the hypotheses tests follow the estimation process. The approach to unit root test credited to Kwiatkowski, Phillips, Schmidt and Shin, KPSS (1992) was employed to examine the time series behaviour of the variables under consideration. The rationale for the KPSS was prompted by the low power often associated with the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) approaches to unit root test. The bandwidth for each of the series is selected automatically based on Newey and West's (1994) bandwidth selection. The methodology of cointegration proposed by Johansen (1988) is relied upon in this study the test whether the economic time series utilized in this study have a long-run relationship.

### 4. Results and Discussions

#### 4.1 Descriptive Statistics

The descriptive statistics for each of the variables are presented below in Table 1.

**Table 1: Descriptive statistics for LOG(RGDP), LOG(NEX), LOG(EXR), and LOG(GEC)**

	LOG(RGDP)	LOG(NEX)	LOG(EXR)	LOG(GEC)
Mean	10.17856	5.311230	3.281229	4.657732
Median	10.00149	5.884922	4.418768	5.483000
Maximum	11.14221	8.669502	5.259784	7.049949
Minimum	9.530920	0.641854	-0.562119	1.410987
Std. Dev.	0.521253	2.659448	2.060740	2.009092
Skewness	0.529273	-0.203607	-0.805884	-0.407663
Kurtosis	1.891728	1.541202	2.079674	1.572595
Jarque-Bera	3.523176	3.440871	5.167190	4.053362
Probability	0.171772	0.178988	0.075502	0.131772
Observations	36	36	36	36

*Source: Author's compilation using E-views 9*

The descriptive statistics presented in Table 1 show that real GDP is associated with the largest average value while the exchange rate has the least mean value over the study period 1980-2015. Similarly, the range of the series indicates that real GDP has the largest value while exchange rate is associated with the least value. The standard deviation indicates that each of the series clustered around their respective mean values. Additionally, it was observed from the skewness of each of the series that all the variables except real GDP are negatively skewed. Again, it was uncovered from the kurtosis that all the underlying variables are associated with thin tails. The associated probability values of the Jarque-Bera statistics for each of the series show that all the variables are normally distributed, indicating that the null hypothesis of normal distribution for the underlying series cannot be rejected at 5 percent level. This observation amongst others called for testing of unit root in the series.

#### 4.2 Unit Root Test

The results of the KPSS stationarity test on each of the series with drift and deterministic trends are presented in Table 2.

**Table 2: KPSS test results**

KPSS test statistics						
S/N	Variables	Levels I (0)	Critical value (5%)	1st diff I(1)	Critical value (5%)	Order of integration
1	LOG(RGDP)	0.202	0.146	0.097	0.146	I(1)
2	LOG(NEX)	0.114	0.146	0.144	0.146	I(0)
3	LOG(EXR)	0.181	0.146	0.098	0.146	I(1)

4	LOG(GEC)	0.156	0.146	0.117	0.146	I(1)
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**Source: Researcher’s Computation using Eviews 9**

The unit root test results reported in Table 2 indicates that only net export is stationary at levels given that its calculated KPSS statistic (0.114) is less than the associated critical value (0.146) 5 percent level. However, the other variables (real GDP, exchange rate and government capital expenditure) are found to be the first difference. This is an indication that the order of integration of the variables is mixed with net export being integrated of order zero while the other variables are integrated of order one. Based on the foregoing, the cointegration test is conducted to examine whether a long-run relationship exists among the underlying series.

**4.3 Cointegration Test**

The Johansen cointegration multivariate test is relied upon to check if long-run relationship exists among the series. The trace and Max-Eigen statistics form the basis for decisions concerning the number of cointegrating equations in the model. The result of the test is presented in Table 3.

**Table 3: Result of Johansen Cointegration Test**

<b>Series: Log(RGDP) log(NEX) log(EXR) log(GEC)</b>				
Hypothesized No. of CE(s)	Trace stat.	5% critical value	Max-Eigen stat.	5% critical value
None*	50.72	47.856	29.52	27.58
At most 1	21.20	29.79	13.80	21.13
At most 2	7.39	15.49	7.38	14.26

At most 3	0.011	3.84	0.011	3.84

*Source: Author's Calculations using Evians 9*

**Note: \* implies rejection of null hypothesis at 5 percent level.**

As observed from the critical values of the Trace and Max-Eigen statistics, the model shows evidence of one cointegration equation. This is indicative that the underlying variables have long-run relationships and can be represented as an error correction model as proposed by Engel and Granger (1987).

#### 4.4 Error Correction Model (ECM)

The estimation of the over-parameterized ECM preceded the parsimonious ECM. The parsimonious ECM which formed basis for the interpretation is summarized below in table 4.

**Table 4: Parsimonious ECM**

Variable	Coefficient	T-Statistic	Prob.
DLOG(RGDP(-1))	0.342433	2.921354	0.0079
DLOG(RGDP(-3))	-0.091747	-0.726079	0.4754
DLOG(NEX)	0.011332	2.300981	0.0312
DLOG(NEX(-1))	0.007595	1.648470	0.1135
DLOG(NEX(-3))	0.013996	2.928683	0.0078
DLOG(EXR)	-0.041668	-2.056878	0.0517
DLOG(GEC(-1))	-0.035350	-2.090170	0.0484
DLOG(GEC(-2))	-0.042433	-2.835092	0.0096
ECM(-1)	-0.041007	-1.335778	0.1953
C	0.051076	5.091223	0.0000
R-squared = 0.634, Prob.(F-statistics) = 0.0000			
Durbin-Watson Stat. = 2.057			

*Source: Author's Calculations using E-views 9*

Table 4 shows the parsimonious ECM. From the result, 63 percent of variations in real GDP are explained by the explanatory variables. The result also reveals that the entire model is significant at 5 per cent level. The outcome of the serial correlation test which relied on Durbin-Watson statistics shows no evidence of autocorrelation in the model. The contemporaneous and lagged



values of net export have the hypothesized positive signs and are significant at 5 and 1 percent levels respectively. Therefore, the null hypothesis of insignificant effects of the net export is rejected. More important, this finding authenticates the theoretical explanation on the link between net export and economic growth. This finding supports the work of Nageri (2013) that foreign trade is growth-enhancing. The policy implication of this finding is that linking the Nigerian economy to the global economic environment through international trade provides opportunities for keeping the economy on the path of growth. The first lag of real GDP is highly significant in explaining changes in current real GDP. This demonstrates that previous GDP value is reliable predictor of current real GDP. The empirical findings also demonstrate that the contemporaneous value of exchange has indirect relationship with real GDP and satisfies the statistical criteria at 5 percent level. This is in tandem with the a priori expectations and the implications of this finding is that exchange variations have dampening effect on the growth process in Nigeria considering the large dependent of the economy on imported producer and consumer goods. Again, both lag 1 and 2 of government capital expenditure are indirectly related with real GDP and significant at 5 and 1 percent levels respectively. This finding conflicts with the a priori expectation, but provides deeper insight into the effectiveness of the funding of critical infrastructure in driving rapid growth in Nigeria. Although the error correction coefficient is relatively low, it possesses the hypothesized negative sign, indicating that the model seemingly reconciles any short-run deviations at a speed of 4 percent.

## 5. Conclusion and Recommendations

The contributions of foreign trade to rapid economic growth in developing countries have long been identified in economic literature. Thus, the growth of real GDP and the benefits it creates can hardly be optimized by any of these countries if the domestic economy is not adequately linked to the global economy through imports and exports. This study empirically examined the impact of foreign trade on economic growth in Nigeria through the effects of some selected variables such as net export, exchange rate and government capital expenditure often related to foreign trade on real GDP. Judging from the empirical findings, it is concluded that real GDP in Nigeria between 1980- 2015 is not significantly driven by government expenditure on capital goods. This implies that the government budgetary allocation to capital expenditure seems to be inadequate in meeting the infrastructural needs of the productive sector to boost competitiveness in the global market to stimulate economic growth. Also, the systematic corruption that has eaten deep into the Nigerian economy cannot be far-fetched. It is also established from the finding that real GDP is significantly driven by net export and exchange rate. This concludes that foreign trade has stimulated economic growth in Nigeria during the period reviewed. The policy recommendations proffered by this study judging from the empirical findings are:

1. Government should ensure that trade policies promote export and reduce the incidence of importing competing goods to ensure that Nigeria optimizes the benefits that foreign trade creates.
2. The monetary authorities should strive to promote the freeing up of the foreign exchange market to get rid of foreign exchange control, drastically reduce or eliminate the dual exchange rate system in Nigeria and make the naira freely convertible at the international market.
3. Public investment should be tailored towards promoting infrastructure development and security to boost domestic production and exports of commodities in which Nigeria enjoys a comparative advantage.

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