



# Policy Brief

## The Effect of the African Continental Free Trade Area on Medium Small and Micro-scale Enterprises in Nigeria

September 2020

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## INTRODUCTION

Free Trade Agreements (FTAs) are established components of regional integration and have been known to promote commodity trade and investment flows by creating an enabling and improved environment for cross-border transaction (Kawai & Wignajara, 2008). The processes may also prompt a diversion of trade and investment away from countries with less favourable business conditions (Yunling, 2010). Thus, the impact of FTAs widely differs across countries on account of a multitude of factors that affect the business environment.

For Nigeria, the impact of AfCFTA as with any other FTA, could vary on account of several market opportunities and constraints to production. Amidst this discourse, the potential impact of the AfCFTA on micro, small and medium enterprises (MSMEs) is the least understood. MSMEs are critical constituents of the Nigerian economy, as they represent about 96 percent of Nigerian businesses and contribute 75 percent to national employment (SMEDAN, 2019). One predominant concern is that the deficient human and technological capacity of MSMEs in Nigeria predisposes them to the negative spillovers potentially associated with free trade and investment exchanges within the continent. However, MSMEs can benefit from greater access to new markets and the possible economic transformation that competition could promote. With the conversation on the recent ratification of the AfCFTA in Nigeria growing, it is therefore imperative to evaluate the extent to which the economic expectations and growth potential of the AfCFTA will benefit Nigerian MSMEs and the cost of these economic opportunities.

## SURVEY METHODOLOGY AND DATA COLLECTION

The data collection procedure for our study focused on four key sectors within the Nigerian economy: wholesale/retail trade, the agricultural and food processing sector, the manufacturing sector and the services sector. These sectors were selected given their high business potential and contributions to GDP, employment and exports.

## SAMPLING OF ENTERPRISES ACROSS STATES

The study employed a multi-stage sampling procedure. In the first stage, Abia State, Anambra State, Kano State, Lagos State and Abuja (FCT) were purposely selected because of the high presence of MSMEs and national representativeness. In the second stage, a proportionate sampling technique was used to determine the number of MSMEs to be sampled in each state. This is based on the sectoral (MSMEs) contribution to GDP, export and employment as reflected in the National Survey of MSMEs by

National Bureau of Statistics (NBS, 2019). Thereafter, in the final stage, simple random sampling was used to select MSMEs for interview through the sectoral MSMEs register. The distribution of the sampled firms (by sector and size) is presented in figure 1.

## FOCUS GROUP DISCUSSION

To strengthen the reliability of our results, and to enrich and triangulate findings from the field survey, structured interview with key informants were conducted. The focus group discussion was held in three different sessions with participants grouped into manufacturing, agricultural and services sector. In addition, a telephone interview was conducted to elicit the perceptions of business leaders regarding the AfCFTA.

## SURVEY RESULTS: MSMES' PERCEPTIONS OF AFCFTA

### Knowledge of AfCFTA

Figure 2 reveals that there is a low level of awareness regarding the existence of the Agreement among MSMEs, as demonstrated by the 67 percent of respondents answering "No" to the posed question. Disaggregated analysis of the MSMEs' awareness by enterprise size shows that only about 18 percent of the micro and small enterprises were aware of the AfCFTA policy. Oppositely, a significantly more substantial portion (67 percent) of the medium-sized enterprises declared their awareness of the agreement.

Further disaggregation by enterprise sectors shows that 97 percent of agricultural MSMEs were not aware of the agreement, while 50 percent of manufacturing sector enterprises are also not aware of the agreement (see Figure 3).

### The Potential Impact of AfCFTA

Among the minority of respondents aware of AfCFTA's existence, there is a general optimism surrounding the prospective effects of its implementation. The pooled results show that 61 percent of this subsample are optimistic of a positive effect of the AfCFTA on their market size while 60 and 59 percent are optimistic of positive effects on cost of materials/inputs and cost of machineries respectively (see Figure 4). Moreover, a majority of the medium enterprises surveyed opined that the AfCFTA will have positive effects in terms of cost of materials/inputs, cost of machineries, market size and production capacity. A high proportion of the small enterprises perceives that the agreement will have positive effects on their businesses in terms of cost of materials/inputs, costs of machinery, production capacity, market size and price of products. Micro enterprises report a lower level of

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optimism across all categories, perhaps reflecting the smaller-scale, less internationally-minded scope of their operations.

Disaggregating the enterprises further by economic sectors, the manufacturing sector displays the most positive attitudes regarding the possible future effects of the AfCFTA on market size, cost of material/inputs and cost of machinery.

### Perceived Threats of AfCFTA to MSMEs

While general optimism could be perceived among respondents (again, limited to the minority aware of the deal in the first place) Figure 5 reveals the share of respondents worried about five potential adverse effects of the AfCFTA to MSMEs in Nigeria. Most prominent among the threats is the fact that cheaper goods from other African countries will be competing against local goods in Nigeria. Other threats to MSMEs in Nigeria that could be associated with the AfCFTA include an increase in foreign competition, reduction in the demand for local goods and dumping of sub-standard products.

### Perceptions on Coronavirus Effects

The survey period overlapped with the onset of the COVID-19 outbreak which, among other things, has also led to the postponement of the commencement period for the AfCFTA. The survey, therefore, sought to explore the impact of COVID-19 on the MSMEs and to identify ways of mitigation that could facilitate an expedited and efficient implementation of AfCFTA in Nigeria. Among the surveyed business 25 percent reported that the pandemic significantly impacted their preparations for AfCFTA; about 46 percent experienced significant effect of the pandemic on their future expansion plans to export abroad; and 63 percent experienced significant effects of the pandemic on plans to import from abroad.

There is no doubt, therefore, that an effective strategy for the implementation of AfCFTA will not only have to incorporate a concerted effort to extend awareness of the deal's existence itself, but also account for the further challenges brought about by the pandemic.

## CGE MODEL

### QUANTITATIVE RESULTS

We used data from 2018 for 60 countries and 20 tradable and non-tradable sectors in the model. We ran the model with free trade for all African countries while leaving tariffs on non-African countries to be at 2018 levels. Although, this paper has implication for all countries in our sample, the report focuses

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on the effects of AfCFTA on Nigeria. Welfare effects are decomposed into volume of trade and term of trade at the sectoral level.

Our results shows modest positive welfare gains to Nigeria with machinery, other transport, textile and metal products as well as textile industries accounting for most of the positive effects on real wage. Nigeria records modest positive welfare effects compared to other African countries. Our simulation results indicate that agriculture, mining, food, and machinery dilute the overall gains from terms of trade as the price of export for these commodities declines relative to the price of their imports. Although there is growth in the export of agricultural products, the terms of trade deterioration in this sector dilutes the overall gains from trade and changes in real wage from the agricultural sector. All together agriculture, mining, food and textile industries contribute about 37 percent to the deterioration in Nigeria's terms of trade. Other manufacturing, wood, paper, and metal products accounts for over 90 percent of Nigeria's total gain from terms of trade improvements and volume of trade.

Moreover, there are significant reductions in export prices of tradable goods. Changes range from 0.8 percent in electrical & machinery and 8.0 percent decline in prices of metal products; a sector that accounts for 13.3 percent in gains from terms of trade. Tariff reductions on imports not only affects prices in that sector but interestingly impacts prices of non-tradable sectors highlighting the importance of supply chain.

Further, we report the changes in Nigeria's import as a result of AfCFTA. Based on model predictions, Nigeria's imports from several African countries including Botswana, Burundi, Ghana, and Namibia decline by more than 10 percent as well as imports from China and Canada by 29.5 and 11.3 percent respectively. Nigeria's imports from Ethiopia triples while imports from Italy (108.8 percent) Japan (100.96 percent) and Zimbabwe double. Imports from OECD and North America increase. Nigeria's imports from Italy, Japan, Netherlands and rest of Europe rises by 108.83 percent, 100.96 percent, 92.73 and 70.83 respectively. On export, Nigeria records growth in exports of agricultural products, food, electrical, and machinery products while exports decline significantly in wood and paper industry.

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### Actionable Plans for Government

The implementation of AfCFTA will require targeted, intelligent government intervention strategies.

The findings in our report suggest the following priorities:

S/N	Plans	How	Who should be responsible	Period
1	Develop a context-specific awareness dissemination strategy	The findings in our report suggest a high level of unfamiliarity with the AfCFTA's existence. MSMEs will not be able to prepare effectively, let alone take full advantage of, AfCFTA without prior awareness.	<ul style="list-style-type: none"> <li>National Action committee on AfCFTA</li> <li>Ministry of Industry, Trade and Investment</li> <li>Federal Ministry of Information and Culture</li> <li>Nigeria Export Promotion Council (NEPC)</li> </ul>	Immediate
		Special attention should be paid to non-digital dissemination strategies to ensure full reach of Nigerian businesses irrespective of their technological participation levels	Federal Ministry of Information and Culture	Immediate
		Partnerships should be developed with local BMOs and business group representatives to better assess how best to engage entrepreneurs	<ul style="list-style-type: none"> <li>National Action committee on AfCFTA</li> <li>Ministry of Industry, Trade and Investment</li> </ul>	Immediate
2	Develop a context-specific training programme	Many MSMEs are often disenfranchised from international trade as a result of the complications associated with compliance to FTAs. Ensuring localised training programmes through partnerships with the private sector and international donors can help fill the technical skills gap that will hamper MSME uptake of AfCFTA	<ul style="list-style-type: none"> <li>National Action committee on AfCFTA</li> <li>Nigeria Customs Service</li> </ul>	Long term
3	Investment in the creation of a more competitive business environment	Electrification and transport infrastructure deficiencies as well as gaps in the Business regulatory environment, are particularly problematic in Nigeria and risk putting Nigerian businesses at a significant disadvantage in relation to continental competitors.	<ul style="list-style-type: none"> <li>Presidency</li> <li>Federal Ministry of Power,</li> <li>DISCOS, GENCOs and</li> <li>Federal Ministry of Transport</li> <li>Nigerian Ports Authority</li> <li>Nigeria Shippers Council</li> <li>Standards Organization of Nigeria</li> <li>National Agency for Food</li> </ul>	Long term

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S/N	Plans	How	Who should be responsible	Period
			and Drug Administration and Control <ul style="list-style-type: none"> <li>Nigeria Agricultural</li> <li>Quarantine Service</li> </ul>	
		A targeted, strategic investment plan should therefore be a priority		Long term
4	Facilitate access to finance for businesses	A strong re-emergence from the COVID crisis is a necessary condition for successful uptake of the AfCFTA agreement. A vast majority of MSMEs declare that easier-to-access business loans are the key policy requirement to ensure post-COVID enterprise sustainability.	CBN, DMBs, MfBs and National Action committee on AfCFTA	Long term
5	Evaluate the progress on AfCFTA	Creation of platform for regular monitoring and evaluation of progress on AfCFTA is required at national and sub-regional levels	National Action committee on AfCFTA	

## Actionable Recommendations for Business Representatives

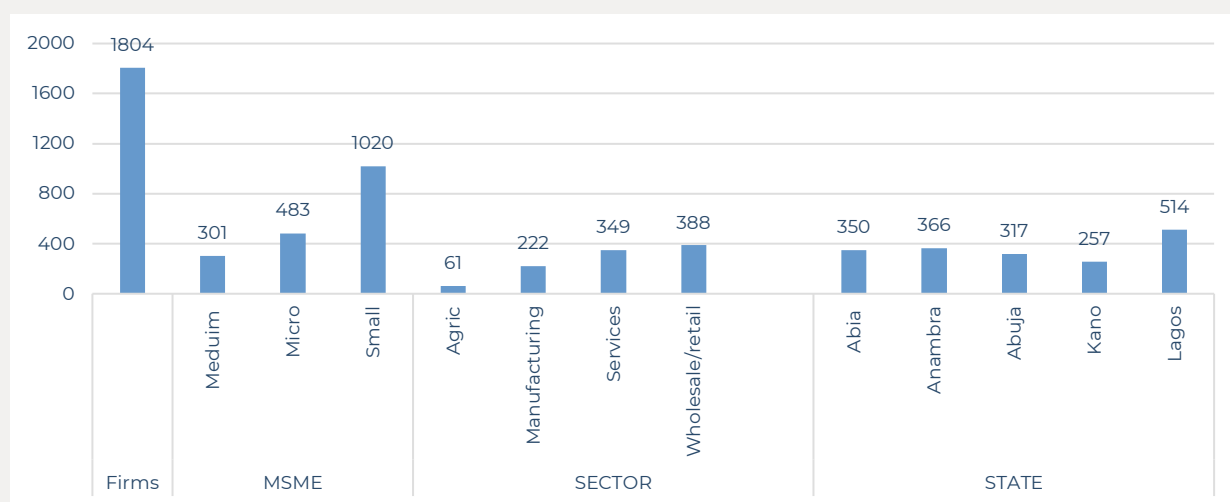
S/N	Plans	How	Who should be responsible	Period
1	Active participation and partnership with government	Given the weakness in information sharing and awareness about AfCFTA, more direct engagement of BMOs will be crucial. This can include in the design of messaging, communication medium and even engaging the BMOs for advocacy and public awareness campaign.	BMOs executives and their members	Immediate
		BMOs can shape the direction and structure of the trade agreement in way that supports their members and engenders Nigerian economic development. This is dependent on their active engagement in deliberation and discussion on key issues arising from the negotiation		Immediate
2	Establish channel of support for members	BMOs need to work with their members on an individual basis to understand the benefits that they can tap into with AfCFTA, while at the same time empowering them with knowledge on mitigating the likely threats.	Executives of BMOs	Immediate
3	Partnership to mitigate threat	There are many steps that firms on their own can do to address threat. For instance, upscaling business management skills and tapping into human resources made available by AfCFTA are things that depend on firms' decision or indecision	BMOs and their members	Long term

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S/N	Plans	How	Who should be responsible	Period
		A platform to track progress of AfCFTA in terms of awareness and economic impact on BMOs should be setup. Firms that are negatively impacted should be reintegrated and supported to compete favourably	BMOs and National Action committee on AfCFTA	Long term
		Given that low comprehension of rules of origin contribute to low uptake of previously agreed FTAs, BMOs need to participate actively on the discussion on how to streamline this issue. This will be key in removing obstacles that apparently affected other FTAs		Long term
4	Partnership for standardization	BMOs need to partner with specific agencies such as SON and NAFDAC to ensure adherence to standards. This will boost the capacity of Nigeria businesses to compete in AfCFTA	BMOs and Agencies such as NAFDAC and SON	Long term
5	Partnership with donors	BMOs need to partner with donors to develop a context-specific information dissemination strategy to allow MSMEs to overcome their inherent knowledge deficit	BMOs and donors	Long term
		Donors can also support BMOs in terms of standardization and meeting the process requirements of AfCFTA	BMOs and donors	Long term
		Targeted funding to support government and BMOs in trade facilitation and other modalities for aid to trade	BMOs and donors	Long term

**Figure 1:** Distribution of Sampled Firms (by Sector and Size)

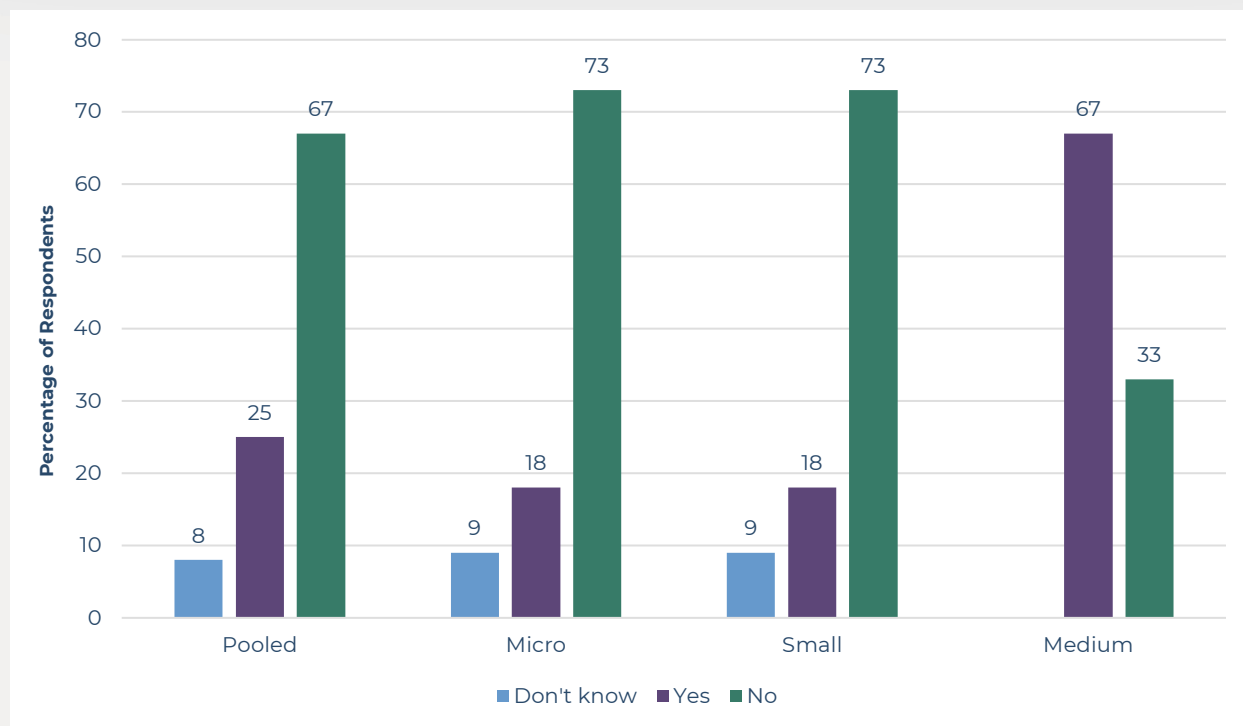




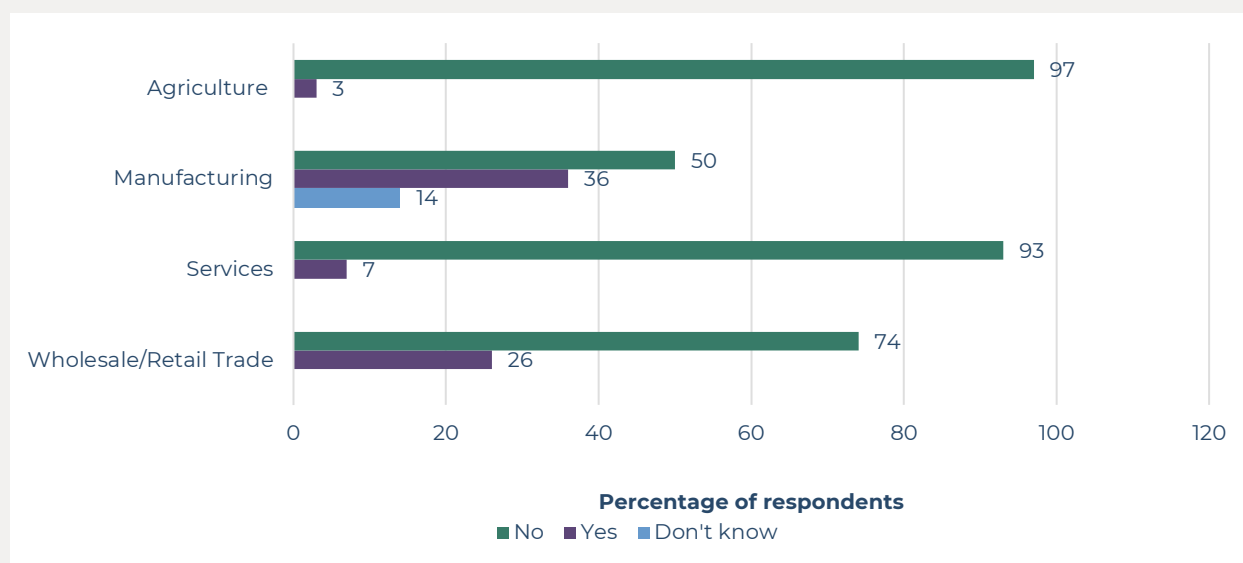
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**Figure 2:** Reported Awareness of AfCFTA by Enterprise Size



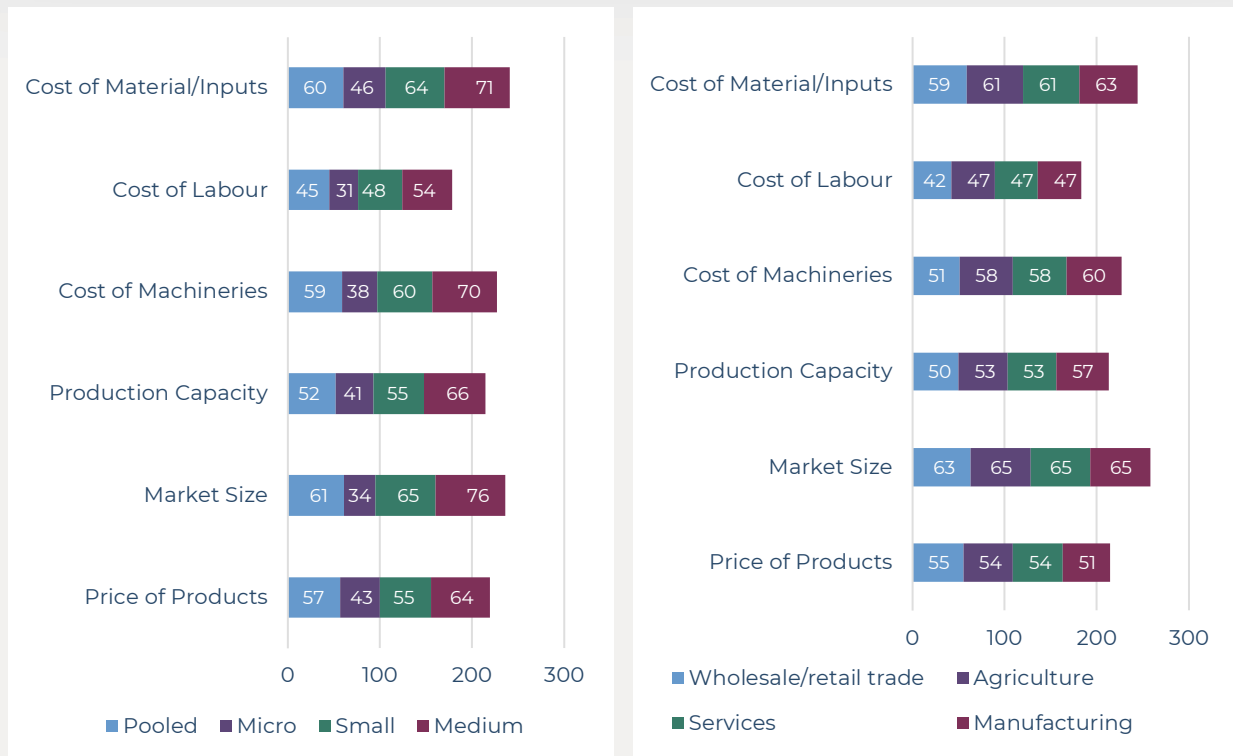
**Figure 3:** Reported Awareness of AfCFTA by Enterprise Sectors



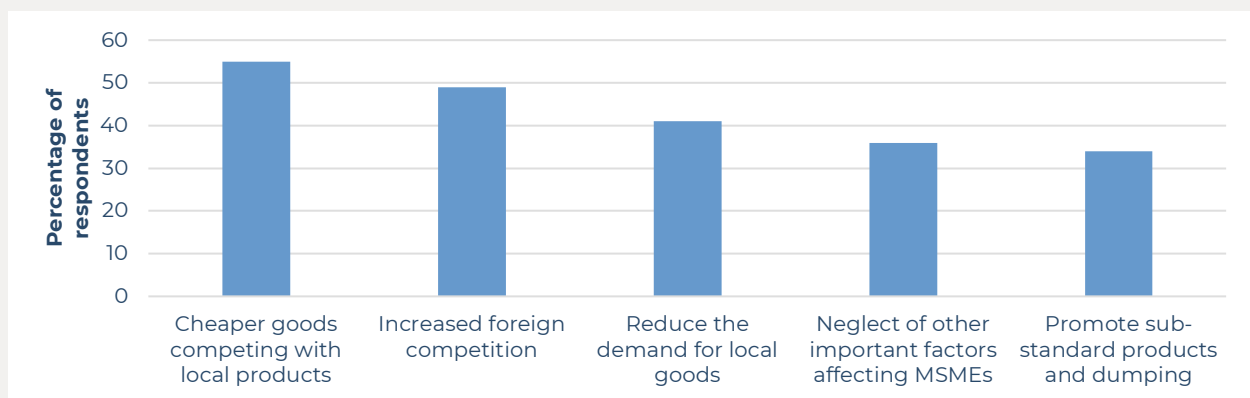
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**Figure 4:** Beliefs on Positive Potential Impacts of AfCFTA



**Figure 5:** Perceived threats of AfCFTA to MSMEs



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**Figure 6:** Reported Effects of COVID-19 on MSMEs

