SUPPORTING ECONOMIC TRANSFORMATION

LOCAL CONTENT POLICIES AND BACKWARD INTEGRATION IN NIGERIA PRESENTATION AT THE NIGERIAN ECONOMIC SUMMIT

Event report

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On 11th October 2017, the Overseas Development Institute (ODI) presented new joint-research with the Nigerian Economic Summit Group (NESG) on Local Content Policies and Backward Integration in Nigeria in Abuja, Nigeria. This presentation formed part of the 23rd Nigerian Economic Summit, an annual forum where Nigeria's private sector engages with the Government on matters of economic development to facilitate policy-informing dialogue, achieve political buy-in and advocate for Nigeria's economic recovery and growth.

Research co-authors Dr Max Mendez-Parra and Dr Neil McCulloch presented an analysis of Nigeria's current economic status, and the key findings and policy recommendations from ODI and NESG's research to an audience of domestic private sector representatives and policymakers.

The Nigerian Economic Summit Group RC:303317

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SUMMARY

- Researchers for the Supporting Economic Transformation (SET) programme at the Overseas Development institute presented new research on local content policy and backward integration in Nigeria to attendees of the Nigerian Economic Summit Group (NESG)'s annual Economic Summit in Abuja, Nigeria.
- Nigeria has achieved significant economic growth in the last decade but this has been accompanied by little in the way of economic transformation. Backward integration policies could help promote higher value-added activities and improve productivity in manufacturing.
- Nigeria has some experience of backward integration policies, though the oil and gas sector has been the primary focus. Additionally, more than 95% of the materials used for cement production in Nigeria are sourced locally. Experience in other sectors, such as food processing, is more nuanced and reflect many of the costs associated with these policies.
- Nigeria can learn much from international experience. Evidence from Norway shows how backward integration policies can support a successful transition to a competitive producer country of a variety of oil field services and equipment. At the same time, the Brazilian experience presents the risks associated with the increase in the downstream industries.
- Stakeholder consultation with government officials and the private sector indicate that there are strong but often opposing views on the best approach to local content policy development. Many firms consider that a mandatory local content share and high tariffs on inputs and raw materials will not be particularly helpful.
- It is crucial for success that **policies are tailored** to work for different sectors, that any **policy is evaluated on the basis of impact on consumers** as well as firms, that **government and other stakeholders work together and are held to account**, and that fundamental **improvements are made to the business climate.**

PRESENTATIONS

Introduction and context setting by Max Mendez-Parra, Senior Research Fellow at ODI

The Nigerian economy and experience of backward integration

Nigeria has experienced rapid growth for a decade, but accompanied by limited structural changes and little economic transformation. The country's high levels of informality and heavy reliance on oil and gas exports has meant little attention has been paid to developing the manufacturing sector or diversifying into more complex products.

Boosting backward linkages could facilitate higher value-added processing and manufacturing activities in Nigeria. If done well, this could stimulate economic development; promote the development of local industries; create economic linkages; build local capacity, capability and technology; develop workforce skills; boost employment; and minimise capital flight.

Nigeria has extensive experience of local content policies in the oil and gas sector. The evidence suggests these policies have helped deepen backward linkages in the sector, for example in fabrication and construction, well construction and completion, control systems and information and communication technology.

Nigeria has also applied local content policy in other sectors. In the cement sector, Nigeria has achieved a significant level of backward integration, with more than 95% of the materials used for cement production in Nigeria sourced locally. Similarly, there are policies to promote backward integration in food processing.

Lessons from international experience

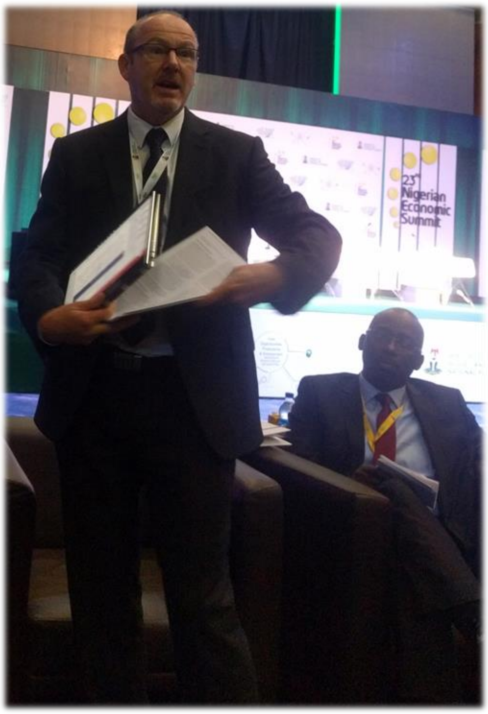
The experience of other countries holds useful lessons for Nigeria. Norway successfully managed its transition to a competitive producer of a variety of oil-field services and equipment. This was not achieved by specifying local content requirements, but by giving priority to procuring from firms based in Norway that were *competitive* in terms of price, quality and delivery time. By contrast, Brazil adopted a nationalistic approach to the development of its indigenous oil and gas sector, by closing out competition from foreign enterprises, resulting in higher costs and lower quality and productivity in the domestic industry.

Outside the oil and gas sector, Indonesia has had a renewed focus on localisation in recent years, including using local content policies prohibited under WTO law, such as a duty exemption for imports of machines, goods and materials if 30% of the total value of machines used are sourced domestically.

Evidence suggests local content requirements in Indonesian manufacturing have been ineffective in reducing firms' dependence on imported inputs. By contrast, local content policies played a positive role in driving the expansion of the garment industry in Bangladesh, in part because policies were backed by efforts to build local capacity within the sector through the establishment of specialised institutions to boost garment-industry skills, encourage technology transfer and the development of local technologies.

Stakeholder consultations and policy recommendations by Neil McCulloch, Director, McCulloch Consulting

Stakeholder views



Nigerian firms face major challenges in strengthening backward linkages. These include difficulties in obtaining adequate and reliable power supply; costly and politically-sensitive processes of gaining access to land; poor-quality transportation infrastructure; the high cost of capital; long lead times before efforts yield rewards; inconsistency of policy implementation; inadequacy of knowledge and skills in the workforce; and lack of foreign exchange.

Stakeholder consultations showed that firms have strong but sometimes opposing views on key local content policies. Most firms felt that specifying a mandatory local content share would be unhelpful. On tariffs, firms that produced processed products for the domestic market using imported inputs were in favour of low tariffs on their raw material inputs and high tariffs on their final product. However, several firms pointed to the negative side effects of tariffs, for example the knock-on impact on downstream sectors, the increase in corruption and the concern that tariffs primarily benefit vested interests, particularly where quotas or bans have been used to create rents in specific sectors. At the same time, there was widespread support for efforts to boost skills and upgrade technology, as well as for special tax and financial incentives to deepen backward linkages.

Senior officials have different visions of what local content policies mean. Some see backward linkages as a way of promoting self-sufficiency under the motto, 'We should grow what we eat and eat what we grow.' Others see local content policy as a way of saving foreign exchange and reducing pressure on the exchange rate. Another group promotes local content to boost productivity and drive export competitiveness. While these arguments have merit, they are not necessarily mutually compatible, since they suggest a focus on different sectors and policy instruments.

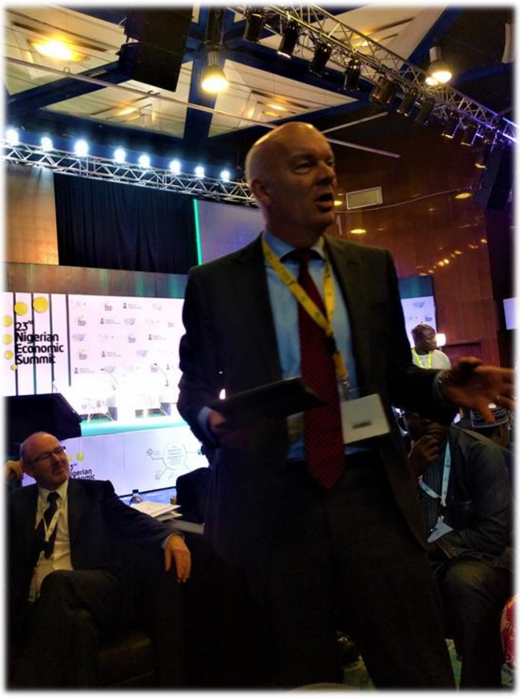
Key policy recommendations

- ***Don't try and make one size fit all.*** Policies should be nuanced by the circumstances of the sector.
- ***Do the maths**.* Evaluation of backward integration should consider whether it creates jobs and boosts investment and value added in the sector, but also the impact on consumers. Policies that provide benefits for a sector or firms while imposing higher costs on consumers should be avoided.
- ***Engage, facilitate and enforce commitments.*** The government should bring together key players to discuss the opportunities and challenges of backward integration, agree investments and the benefits they will accrue. Once agreed, the players should be held to account for delivery.
- ***Focus on fundamental improvements to the business climate.*** Many of the challenges to backward integration are challenges to doing business in general. Improving the business enabling environment is essential not only to the success of backward integration but also to the growth of Nigeria's economy overall.

DISCUSSION

Remarks by Hendrik A. Wymenga, Technical Director, Nigerian Breweries PLC

Mr Wymenga highlighted the importance of creating backward linkages. He highlighted the experience of his former company, for where out of 3,000 employees, only two are not Nigerian.



Nevertheless, he highlighted that local content policies and backward integration is only sustainable as long as they are 'win-win'. This means that they should benefit firms, producers and farmers all along the production chain and not just in a certain sector. In this sense, backward linkages should be formed by working together all the segments of the chain.

He advocated for the creation of a work plan between the private sector and the Government to develop backward linkages. This plan should include the following points:

- Bring investment, specially to step in in certain links of the chain that need to be upgraded.
- Identify gaps in the chain.
- Assist in building capacity of promising suppliers.
- Improve technical education.
- Develop industrial parks.

He refrained from advocating on protectionism as a measure to develop backward linkages but encouraged the creation of an enabling environment.

Comments by Lolu Akinyemi, Procurement Director, Lafarge Africa PLC

Mr Akinyemi advocated to allow market forces to operate. In particular, he called on policymakers to shift their focus from import-substitution policies. The government and the private sector should work together to make production more competitive in the world markets, increasing the promotion of Nigerian products.

In particular, Mr Akinyemi called to improve the access to credit to export as the lack thereof it is a major constraint to expansion. In this sense, the expansion of exports will expand demand of domestic production that will contribute to the development of backward linkages.

Although protectionism must be avoided, he emphasized the importance of enforcing controls at borders to avoid smuggling as a way of level the playing field for local firms.

SET is an applied research and advisory programme at the ODI, funded by DFID. The programme's reports, dialogue sessions and events cover four dimensions of a country's experience in economic transformation: (i) what is happening? (ii) why is it happening? (iii) what should be done? and (iv) how to make it happen. For more information, visit set.odi.org.