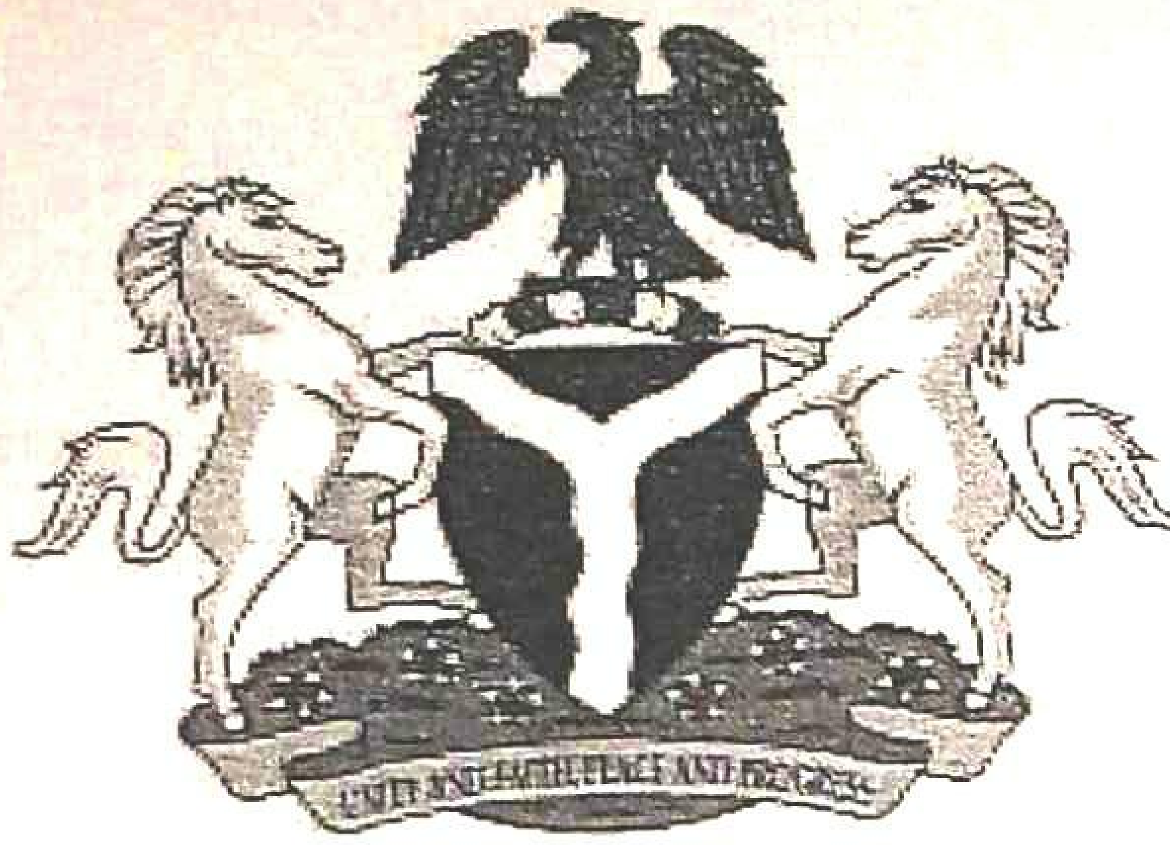

REPORT

OF THE NATIONAL ECONOMIC MANAGEMENT TEAM (NEMT) COMMITTEE ON THE REVIEW OF TARIFFS AND FISCAL INCENTIVES

VOLUME II: Main Report

FEDERAL MINISTRY OF FINANCE
ABUJA, NIGERIA

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EXECUTIVE SUMMARY

Nigeria's objectives of imposing tariffs have traditionally been to raise revenue for Government, and to protect certain sensitive domestic industries. Some Nigerian stakeholders perceive that the traditional objectives of imposing tariffs has been impinged by the country's adoption of the ECOWAS Common External Tariffs (CET) one of the prerequisites to achieving a common market in West Africa. Therefore, analyses of the issues around the existing tariff structure are required to generate informed judgment about the national as well as regional policy implications and the available options. In addition, as tariff protection has been traditionally provided alongside fiscal incentives, required proper evaluation of their impact on domestic industries has not been conducted, leading to perennial and consistent demand for more protection and incentives to offset inevitable policy impacts. At this stage, there is a need to holistically assess the simultaneous application of both tariffs and fiscal incentives to encourage domestic production with minimal cost to the Government.

2. The National Economic Management Team (NEMT) therefore set up a Technical Committee on the Review of Tariff Structure and Fiscal Incentives in Nigeria to analyse these issues, employing the following terms of reference (ToR).

TERMS OF REFERENCE (TOR): REVIEW OF TARIFF STRUCTURE

(i) Review the existing tariff structure in Nigeria, paying particular attention to its evolution and objectives;

(ii) Review existing studies on the tariff structure, with particular focus on its impact, limitations and mitigation measures;

(iii) Examine the tariff structure of selected emerging economies that are achieving high rates of economic growth and diversification, especially in the real sector, with a view to adapting them to suit the Nigerian situation; and

(iv) Recommend appropriate changes in the existing tariff structure and import protection regime, as well as other complementary and compensatory measures, for enhancing productivity in the real sector and facilitating rapid economic growth and development.

TERMS OF REFERENCE (TOR): REVIEW OF FISCAL INCENTIVES

(i) Review the existing structure of fiscal incentives in Nigeria, paying particular attention to its evolution, objectives and modalities.

(ii) Review existing studies on fiscal incentives, with particular focus on their impact and limitations.

(iii) Examine the fiscal incentives of selected rapid-growth and diversified emerging economies with a view to adapting them to suit the Nigerian situation.

(iv) Recommend appropriate changes in Nigeria's fiscal incentives, with the objectives of enhancing productivity in the real sector, promoting greater diversification, and facilitating rapid economic growth and development.

MEMBERSHIP OF THE COMMITTEE

4. The members of the Committee are as follows:

(i)	Prof. Ademola Oyejide – National Economic Intelligence Committee	-	Chairman
(ii)	Dr. Obadiah Mailafia – Centre for Policy and Economic Research	-	Member
(iii)	Mr. Frank Nweke Jnr. – Nigerian Economic Summit Group	-	Member
(iv)	Mr. Tunde Lawal – National Planning Commission	-	Member
(v)	Mr. Yakubu Aliyu – Federal Ministry of Finance	-	Member
(vi)	Dr. R. K. Attahiru – Federal Ministry of Commerce and Industry	-	Member
(vii)	Mr. L. F. Ntorue – Federal Ministry of Finance	-	Secretary

APPROACH

3. The approach adopted for the Review is three-pronged involving desk study; collation, summarization and harmonization of stakeholders written input; and dissemination of initial findings to a stakeholders' consultative forum for their input. The stakeholders that responded include: Manufacturers Association of Nigeria (MAN), Ministry of Commerce and Industry, Kaduna State, Nigeria Export Processing Zones Authority, Nigerian Export Promotion Council, Association of Luxury Bus Owners of

Nigeria, Federal Ministry of Finance, Budget Office, Small and Medium Enterprises Development Agency of Nigeria, Cement Manufacturers' Association of Nigeria, and GZ industries

5. This Report is in three volumes. Volume I provide the Executive Summary arranged into two main parts. Part 1 deals with the introductory section containing the Preamble, Terms of Reference (ToR), Committee Membership and the Approach used in the analyses. Part 2 deals with the Issues, Summary of Findings and Recommendations, also organized into two sub-sections each for *Existing Tariff Structure* and *Existing Fiscal Incentives*. Volume II contains an enlarged report of the reviews along with consultants' main reports as appendices. In Volume III, the compendium summary of stakeholders' inputs as well as their written communication are presented.

COMMITTEE'S FINDING ON TARIFF STRUCTURE

6. Government's objectives of imposing tariffs are to progressively liberalise the import regime with a view to promoting efficiency and international competitiveness of domestic industries and do away with undesirable protection, reduce the uncertainty and unpredictability of the trade policy regime, and harmonize trade practices with those of other ECOWAS countries. However, the instruments and the commitment to implementation of trade policy have not been so consistent with Government's articulated objectives.

7. The current structure of Nigeria's tariffs is in compliance with the ECOWAS CET with 5 tariff bands that range between 0% and 35%. These bands are in category 0 (0 per cent) for industrial machinery/equipment and medicaments such as malaria drugs, polio vaccines, HIV Test Kits, Treated Mosquito nets, etc; category 1 (5%) for industrial raw materials; category 2 (10%) for semi-finished manufactured goods; category 3 (20%) for finished goods; and category 4 (35%) for manufactured goods of strategic importance to the nation.

8. As a result of the adoption of the CET, the protection of domestic producers of all products on the average reduced by more than 50%. In the case of agriculture, the protection was reduced by almost 70%. Many consumer products such as textiles and poultry products have been under import prohibition. If this is considered, the reduction

in the protection of domestic producers becomes very substantial. The reduction of protection to domestic producers was also sudden as normal time required for them to absorb the fact of intense competition from foreign producers was not observed. Despite the size and suddenness of the reduction in the protection to domestic industrialists and farmers, government did not directly provide measures that would permit domestic producers to absorb the sudden shock that emanated from adopting low tariff rates and cancelling import prohibition.

9. Inputs from some of the stakeholders indicated that in adopting CET, there is need for consistency and if import prohibition were to be removed, those products affected should attract the highest tariff of 35%. The highest tariff in the Francophone ECOWAS was 20% before the agreement to adopt the 5th band of 35% suggested by Nigeria. The adoption of the 5th band of 35% by the Francophone ECOWAS, after intense negotiations, made them violate their existing WTO rules. This fact makes it difficult to negotiate the 5th band to a level higher than 35% and led to Nigeria's reduction of the 50% maximum tariff adopted in 2005.

10. Though the CET precludes the use of waivers and exemptions, just as it does import prohibitions, these instruments will no longer be available for use to favour particular industries over others. The existing studies showed that the impact of the CET structure will be on the tariff structure, Government fiscal revenue, and Nigeria's imports as well as on Nigeria's process of industrialization. The studies suggest that the current CET structure can help ameliorate the problems of cumbersome customs administration and may also reduce smuggling. It also shows that Government may lose significant revenue, estimated between N100 billion and N150 billion annually as a result of the current structure between 6.9% and 8.8% of total Government revenue per annum, if other complementary measures to reduce this impact are not implemented.

11. Accordingly, Government may lose less revenue by collecting import duties more effectively, and eliminating exemptions. Total loss of Government revenue could reduce to about N50 billion annually. Nigeria is likely to increase imports by between 3 % and 6% representing between N34.4billion and N68.8billion of 2002 Imports at current prices. Available economy-wide study suggests that the negative impact of the CET on

Nigeria may be small due to higher import of agricultural goods by 7% and decline in the import of manufactured goods by 4% in both the short and long run.

12. The impact of the CET as a result of replacing import prohibition with the maximum tariff of 35% is likely to increase imports. However, increased imports would affect mainly domestically produced goods such as medicaments; African print fabrics, Carpets, Lace Fabrics, Towels; Vegetable Oils and Fats; Maize, Millet, Sorghum; Maize Flour; Pork, Beef, Mutton, Lamb and Goat Meat; Frozen Poultry; Furniture; Foot Wears and Bags. This increased would nonetheless bring additional import duty to the Government. There is a dearth of very recent studies on Nigeria's tariffs and fiscal incentives as well as on the impacts on the economy. The applicability of the results contained in the studies needs to be updated with current studies.

13. The type of mitigating measures that have been applied when embarking on drastic reduction of protection to domestic producers include phasing in of the tariff liberalization for about 10 years, and embarking on sweeping social and economic reforms. These reforms involve the following:

(i) Labour market reforms that allow flexible labour laws to enhance movement of workers within and between sectors; and strengthening of training programme to provide qualified employees for export-oriented companies;

(ii) Technological support to private firms to improve ability to compete through incentives that encourage adoption of new technologies; and

(iii) Improvement of domestic investment environment;

- establishment of effective competition policy, and
- establishment of social safety nets to compensate displaced workers. Most of the economic reforms embarked upon have not been targeted at addressing the challenges consequent upon adopting the CET on domestic producers and workers.

14. Nigeria's current tariffs structure on the average compares with proximate countries' tariffs such as Brazil, India, China, Malaysia, Indonesia, South Korea, and South Africa particularly in the manufacturing sector and considering all products together. However, Nigeria has the lowest tariff protection in agriculture when compared

to South Korea, India, and China. It also has the lowest protection in textiles and clothing when compared to South Africa and Brazil. All these countries use strict international standards to combat unbridled imports, including import prohibitions, particularly as they relate to the protection of health, safety, security, public morality, and the environment.

15. The global average rate of protection for domestic producers is between 15% and 30%, though there are some exceptionally high tariffs on products considered to be very strategic in some countries. Customs Unions such as the European Union, Southern Africa Customs Union, among others, use additional WTO-compliant protective measures to protect their domestic producers even when they have such low tariff rates as the ECOWAS CET. Such measures address sudden influx of imports, dumping and export subsidies on the imported products. These measures include safeguard measures, and anti dumping and countervailing duties to immediately stop influx of imports due to import liberalisation. These countries possess the institutional arrangement to implement safeguards, and anti-dumping and countervailing duties to stop import surges due to tariff liberalisation.

COMMITTEE'S RECOMMENDATIONS ON TARIFFS:

Maintain CET with WTO-Compliant Protection

16. Considering the manner of evolution of the ECOWAS Common External Tariffs, that involved consultations and intra-ECOWAS negotiations and agreement, it is recommended that the current tariff structure be retained. However, the CET should be applied in combination with standard WTO-compliant protective measures that will allow relevant Government agency protect productive sectors as the case arises. The ability to use these additional instruments depends on the existence of well-staffed professionally competent agency of Government that can deal with issues relating to unfair trade practices, dumping, import surges and subsidized imports.

17. Nigeria does not presently have such an agency, therefore, in line with WTO rules and the practices in some countries, it is recommended that Government should establish a Nigeria Trade and Competition Commission to be able to promptly address the following issues:

(i) Determination of the volume or price triggers;

(ii) Prompt data gathering through real time direct link to Customs to obtain data on minute by minute basis to swiftly determine when triggers have been breached;

(iii) Speedy transmission of data to relevant bodies for reports; and

(iv) Investigation of injury cases by industry and the preparation and invocation of protective measures and notify ECOWAS.

Increase Effective Participation in WTO and ECOWAS Negotiations

18. Nigeria should use and strengthen existing machinery to follow with keen interest, with a view to influencing, the formulation process of special protective measures of the ECOWAS Commission. The machinery should also follow the Special Safeguard Mechanism under discussion in the Doha Round to make this protective measures benefit Nigerian producers. As the CET does not preclude the use of special levies which are also in the process of harmonization at the ECOWAS level, Nigeria should as well effectively participate in this process to ensure that existing important levies in Nigeria are retained.

Adopt WTO-Complaint Non-Tariff Barriers in Trade Policy

19. There is need to strengthen the capacity of the Standards Organization of Nigeria (SON) and the National Foods and Drugs Administration Agency (NAFDAC) to increase their relevance to Nigeria's trade policy.

Conduct Regular Impact Studies

20. In view of the dearth of studies to properly evaluate the impact of tariffs and fiscal incentives, there is need for more detailed studies on the impact of tariff on the economy. Therefore, government needs to conduct regular detailed studies to evaluate these impacts.

Provide Short and Long-term Support Framework

21. Considering the challenges of the CET, it is recommended that government should provide support to domestic producers affected by the drastic reduction in tariffs. In the long term, existing incentives need to be restructured to take cognizance of injured firms due to tariff or import liberalization. This is because existing incentives are designed around company performance criteria which injured firms will not meet.

Incentives to combat problems created by import liberalization can take the following form:

(i) Increased asset depreciation allowance to 10%;

(ii) Tax relief for research and development;

(iii) Re-investment allowance;

(iv) Minimum local raw material utilization; and

(v) Reduced Companies Income Tax to 10%.

22. The burden of proof to benefit from these incentives lies on the beneficiary. The incentives should be stopped immediately, if there is evidence of the beneficiary regaining its production base and market.

Strengthen Employment, Export, and Safety Nets Agencies

23. There are some Government actions which have a semblance of mitigation measures but are not linked to tariff liberalization shocks. Therefore, the government should strengthen established mechanism for manpower training to deal with trade policy related unemployment. In effect, the National Directorate of Employment (NDE) should design ways to retrain and retool workers to migrate to other areas export sector (e.g. Garments production under the African Growth and Opportunities Act (AGOA)). In addition, Government should expand existing social safety nets to compensate displaced workers due to import liberalization (e.g. National Poverty Eradication Programme (NAPEP).

24. Government should also strengthen policy on export development through the Nigeria Export Promotion Council (NEPC)) to help producers to shift production where possible to the export sector to take advantage of improved market access created by virtue of such trade negotiations and agreements such as the Doha Round and the Economic Partnership Agreement.

Institute an Appropriate Fiscal Incentives Regime

25. Government should correctly align the list of incentives to the objectives of the need to correct for externalities and mitigate the effects of other policy-induced distortions. All incentives should be potentially made available to all the industries and case-by-case granting of incentives should be discontinued. Government should rationalize the number of incentive granting bodies and should in case more than one

incentive granting body emerged in the process of harmonization. The Committee also recommended that an effective coordination mechanism should be instituted to ensure that efforts are neither duplicated nor permit double-dipping. The processes and procedures for granting fiscal incentives need to be clearly stated, simplified, readily available and accessible to all stakeholders.

Monitoring and Evaluation Framework for Fiscal Incentives

26. Monitoring and Evaluation of fiscal incentives granted should be on regular basis with a view to ascertain the costs and benefits of incentives, noting that the costs include administrative costs and forgone Government revenue. It should also ascertain the achievement of targeted goals and check for potential abuses.

COMMITTEE'S FINDING ON FISCAL INCENTIVES

27. The Committee's findings on fiscal incentives include the following:

(i) Objectives of fiscal incentives may not have been properly articulated due to multiplicity of incentives;

(ii) The procedures and modalities for granting incentives are complex because of too many Agencies are involved;

(iv) It appears that not all stakeholders have full knowledge of available fiscal incentives system in the country;

(v) More firms benefit from Export Expansion Grant Scheme (EEG) than any other schemes under comparison;

(vi) Trade Finance Support tends to provide more funds for firms on the average;

(vii) The low number of beneficiaries and amounts under the Duty Drawback Scheme (DDS) point to problems relating to red-tapeism in the administration of the scheme rather than inadequate funds to support it;

(viii) The high average amount per firm under the Rediscounting and Refinancing Facility (RRF)/ Stocking Facility (SF) scheme may have been provided to large export firms;

(ix) The Presidential Committee on the Review of Incentives, Waivers and Concessions made some recommendations especially on how to reform

fiscal incentives. Government has accepted most of the recommendations;

(x) Nigeria has the highest number of export incentives among countries like Uganda, Malawi, Kenya, Botswana, Zimbabwe and Ghana;

(xi) The system of fiscal incentives in Nigeria is lacking in focus and poorly administered unlike the systems in South Africa and Kenya which are characterized with clear policy objectives and targeted tools;

(xii) Fiscal incentives in most countries are dynamic as they are reviewed regularly. For instance, the Mauritius government reformed its tax incentive system in 2006 by changing from numerous tax breaks and exemptions to a low-tax regime and promotion of targeted projects. The regime before the reform in 2006 was very complex and created vast opportunities for abuse and tax avoidance and thus created inefficiency and bias against small enterprises;

(xiii) Two main characteristics of Brazil's incentives regime provide Nigeria with useful lessons; the dominant use of official credits at rates below the market rate and often linked to local content requirements, and Incentives for regional development are through Free Trade Zones (FTZs);

(xiv) Taxes are important but they are not the most important factor in investment decisions. Economic stability, adequate infrastructure, natural resources, human capital, and efficient delivery of public goods are all the more important;

(xv) Tax incentives are not as important as certainty and simplicity in the operation of the tax system. As long as taxes are moderate and the tax system well administered, a system without special incentives may be more attractive to investors than one that regulates market choices through special provisions;

(xvi) Tax incentives are not an effective way of attracting Foreign Direct Investment as the home may tax repatriated profits and thus result in an unintended transfer from the source country to the home country;

(xvii) Income Tax Holidays or Tax Exemptions are a particularly inefficient way to promote investment in new enterprises, which typically are unprofitable in the early years and thus unlikely to benefit. The principal beneficiaries are more likely to be those companies that are profitable from the outset and might not need incentives;

(xviii) Fiscal incentives are used essentially to transfer resources from the general group to a specific sub-group e. g, the cost of fiscal incentives is borne by all tax-payers, while the benefits tend to accrue to particular sub-groups;

(xix) Cost- benefit analysis of these incentives is not feasible because of lack of data;

(xx) Performance of the non-oil sector has not been significant even from the benefit side;

COMMITTEE'S RECOMMENDATIONS ON FISCAL INCENTIVES:

Phase out the Current Regime of Incentives

28. The Committee has recommended the need to stop granting new incentives and allow those that are already granted to terminate at the expiration date. Since there will always be clamour for incentives, a general incentives to all the manufacturing firms of, say, 5% reduction in the current rate of company income tax may be introduced. This will place all the firms on equal footing. This suggestion is not new as IMF (2008) and the Presidential Committee on Incentives, Concessions and Waivers (2009) had suggested same. This may be sufficient incentive to attract and or retained firms especially those that are desirous to locate within the West Africa sub-region[1]. Indeed, Nigeria's current company income tax rate compares favourably with regional rates[2]. However, there is the need to evaluate the impact of such reduction on the fiscal revenue of the Government. In this case, the tax avoidance occasioned by the complexities introduced by the administration of fiscal incentives would be minimized.

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[1] As noted earlier, fiscal incentives are not the priority in investment decision of firms.
[2] The current company income tax rates are 35% for Cote d'Ivoire, 32% for Mozambique, 30% for Kenya, Tanzania and Uganda, 25% for Ghana.

Reform the Fiscal Incentives in the Country

29. The reform will make the fiscal incentives in the country more selective, national goal oriented, transparent and devoid of cumbersome and complex administrative procedure. Some of the elements of the reforms are as follows:

(i) The list of incentives needs to be greatly pruned down to manageable level and targeted at a few carefully selected sectors based on the national priorities and growth objectives;

(ii) There is also the need to rationalize list of incentive granting bodies. It may be convenient in the short run to ensure effective coordination and harmonization of activities of these bodies but the ultimate goal is to have only one body responsible for the administration of fiscal incentives in the country. The rationalization of the list of incentives as well as granting bodies is among to promote efficiency and check cases of abuse such as double dipping;

(iii) The procedures and processes for granting fiscal incentives need to be revised along the following lines:

- The process and criteria for granting different incentives must be clearly stated and readily available and accessible to all stakeholders.
- Rather than individual firms competing among themselves to have access to a particular set of incentives, the Government should consider granting the incentives to groups of stakeholders (automatic versus discretionary incentives).

(iv) Evaluation and monitoring of fiscal incentives granted should be on regular basis to:

- Ascertain the achievement of targeted goals.
- Check for potential abuses.
- Ascertain the costs and benefits incentives especially in relation to administrative costs and also forgone Government revenue.

(v) To minimize abuse and increase both efficiency and effectiveness of the fiscal incentive, the design of fiscal incentives should:

- Limit their scope.

- Reduce discretionary criteria for granting them.
- Ensure transparency and predictability.
- Place the burden of proof on the beneficiaries to establish that they do indeed remove ascertainable negative externalities and/or induce positive ones.

(vi) Free Trade Zones have potentials for driving the growth and development of the Nigerian economy and their added advantages include amenable to regional incentives, makes tax administration is easier because benefiting firms are located in zones. However, these zones must be properly established and efficiently administered especially the basic infrastructure must be in place and well maintained. To ensure optimal functioning of these zones, the establishment, operations, and management should be thoroughly reviewed with a view to:

- Ensure that the business environment in the zone meets international standard.
- Double dipping and other sharp practices are minimized.
- Differential and preferential incentives may be considered to address regional development issues. For example, firms locating in a zone that is located in an economically disadvantage area may be granted additional incentives or preferential rates than what obtains in other zones.
- Currently there are two Authorities responsible for administering FTZs in the country. There is the need to merge them to avoid.

BACKGROUND TO THE REVIEW

PREAMBLE

The fundamental objectives of development policy are to promote growth and development. The vehicle for achieving these are the medium and long term development plans which are the 7-Point Agenda and the Vision 20: 2020 for Nigeria. Tariffs and fiscal incentives constitute the instruments for achieving the objectives.

2. The rationale for levying tariffs on imported goods is to raise revenue for Government, and to protect certain sensitive domestic industries. Nigeria's objectives of imposing tariffs are similar, and strategies to achieve these objectives have been to change the tariff rates on imported goods as the need arises either to maximize Government revenues or to ensure that particular industries are shielded from the negative effects of import competition.

3. In line with the objectives of World Trade Organization (WTO) for free global trade, many developed and developing countries are relying less and less on tariff revenue and more on other forms of taxation, as well as depending less on tariffs and more on Non-Tariff Barriers (NTBs) to protect their domestic industries. However, there is a perception by some Nigerian stakeholders that the traditional objectives of imposing tariffs may no longer be met by the country's adoption of the ECOWAS Common External Tariffs (CET). Hence, if this perception is not technically analyzed, it may pose a real danger for the current tariff structure in terms of the possibility of hasty reversal or adjustment without fully understanding the national as well as regional policy implications and the available options.

4. Notwithstanding, Nigeria has traditionally provided tariff protection alongside fiscal incentives without proper evaluation of their impact on domestic industries. This shortcoming has led to perennial and consistent demand for more protection and incentives. At a stage, there is a need to holistically assess the simultaneous application of both tariffs and fiscal incentives to encourage domestic production with minimal cost to the Government.

5. In view of the above, a Technical Committee on the Review of Tariff Structure and Fiscal Incentives in Nigeria was set up by the National Economic Management Team (NEMT) with the following Terms of Reference (ToR).

Terms of Reference (ToR): Review of Tariff Structure

(i) Review the existing tariff structure in Nigeria, paying particular attention to its evolution and objectives;

(ii) Review existing studies on the tariff structure, with particular focus on its impact, limitations and mitigation measures;

(iii) Examine the tariff structure of selected emerging economies that are achieving high rates of economic growth and diversification, especially in the real sector, with a view to adapting them to suit the Nigerian situation; and

(iv) Recommend appropriate changes in the existing tariff structure and import protection regime, as well as other complementary and compensatory measures, for enhancing productivity in the real sector and facilitating rapid economic growth and development.

Terms of Reference (ToR): Review of Fiscal Incentives

(i) Review the existing structure of fiscal incentives in Nigeria, paying particular attention to its evolution, objectives and modalities;

(ii) Review existing studies on fiscal incentives, with particular focus on their impact and limitations;

(iii) Examine the fiscal incentives of selected rapid-growth and diversified emerging economies with a view to adapting them to suit the Nigerian situation; and

(iv) Recommend appropriate changes in Nigeria's fiscal incentives, with the objectives of enhancing productivity in the real sector, promoting greater diversification, and facilitating rapid economic growth and development.

Membership of the Committee

6. The members of the Committee are as follows:

(i)	Prof. Ademola Oyejide – National Economic Intelligence Committee	-	Chairman
(ii)	Dr. Obadiah Mailafia – Centre for Policy and Economic Research	-	Member
(iii)	Mr. Frank Nweke Jnr. – Nigerian Economic Summit Group	-	Member

(iv)	Mr. Tunde Lawal – National Planning Commission	-	Member
(v)	Mr. Yakubu Aliyu – Federal Ministry of Finance	-	Member
(vi)	Dr. R. K. Attahiru – Federal Ministry of Commerce and Industry	-	Member
(vii)	Mr. L. F. Ntorue – Federal Ministry of Finance	-	Secretary

Approach

7. The approach adopted for the Review is three-pronged involving desk study; collation, summarization and harmonization of stakeholders written input; and dissemination of initial findings to a stakeholders' consultative forum for their input. The stakeholders that responded include: Manufacturers Association of Nigeria (MAN), Ministry of Commerce and Industry, Kaduna State, Nigeria Export Processing Zones Authority, Nigerian Export Promotion Council, Association of Luxury Bus Owners of Nigeria, Federal Ministry of Finance, Budget Office, Small and Medium Enterprises Development Agency of Nigeria, Cement Manufacturers' Association of Nigeria, and GZ industries.

8. This Report is in three volumes. Volume I provide the Executive Summary arranged into two main parts. Part 1 deals with the introductory section containing the Preamble, Terms of Reference (ToR), Committee Membership and the Approach used in the analyses. Part 2 deals with the Issues, Summary of Findings and Recommendations, also organized into two sub-sections each for *Existing Tariff Structure* and *Existing Fiscal Incentives*. Volume II contains an enlarged report of the reviews along with Consultants' main reports as appendices. In Volume III, the compendium summary of stakeholders' inputs as well as their written communication are presented.

REVIEW ON NIGERIA TARIFF STRCUTURE

INTRODUCTION

9. In principle, the justification and principal objectives for levying tariffs on imported goods include the need to raise revenue for the government and to protect certain domestic industries. In practice, these reasons have assumed different importance, with many developed and developing countries relying less and less on tariff revenue and more on income taxes, as well as depending less on tariffs and more on non-tariff barriers (NTBs) to protect their domestic industries, particularly with the successive GATT and WTO rounds which, in line with their main objective of dismantling tariff and non-tariff barriers to international flow of goods and services, have been quite successful with reducing tariffs generally, while the achievement of similar objectives regarding non-tariff barriers remains quite challenging. Nigeria's objectives of imposing tariffs are similar, and strategies to achieve this objective have been to change the tariff rates on imported goods as the need arises either to maximize government revenues or to ensure that particular industries are shielded from the negative effects of import competition.

10. There is a perception by certain set of stakeholders that the general objectives may no longer be met by Nigeria's adoption of the ECOWAS CET. Hence, if not technically analyzed, this perception may pose a real danger for the current tariff structure in terms of the possibility of hasty reversal or adjustment without fully understanding the national as well as regional policy implications and the available options.

CONSIDERATION OF THE TERMS OF REFERENCE: TARIFF STRUCTURE:

TOR1: Review of the Existing Tariff Structure in Nigeria: Evolution and Objectives.

11. The Federal Ministry of Commerce and Industry since 2002 in its *Trade Policy Document* identified four main objectives of trade policy that target the agricultural sector. These are to increase food production, increase production of raw materials inputs for further processing within the economy, promote cash crop production as a means of earning foreign exchange and to encourage export diversification. In industry,

the goals are to use trade policy to stimulate competition and foster investment in Nigeria with a bias towards the export market while also developing the skills and capacity to compete with imports in the domestic market; to progressively liberalise the import regime, with a view to promoting efficiency and international competitiveness of domestic industries and do away with undesirable protection.

12. More recently, the National Economic Empowerment and Development Strategy (NEEDS) and the 7-Point Agenda documents have sought to deepen Nigeria's integration with the rest of the world and to maximize the benefits of strategic integration, using regional integration and trade as the two main instruments for maximizing the benefits of globalization. Both recognize the several trade-related constraints faced by Nigerian producers in their efforts to globally integrate. These include high cost of doing business; weak infrastructures; poorly implemented tariff regimes; massive smuggling, counterfeiting, and dumping of products; inadequate standardization required for products to compete internationally; unfavourable international trade rules; and unpredictable trade policy stance covering application of tariffs and exemptions, high transactions costs at ports, cumbersome customs clearance procedures, and the use of import bans resulting in average barriers that exceeded those of the other ECOWAS countries. Hence both have as policy thrusts to drastically reduce the uncertainty and unpredictability of the trade policy regime, harmonize trade practices with those of other ECOWAS countries, respect Nigeria's obligations under the multilateral and regional trading system, and create a conducive and competitive environment in which Nigerian businesses can flourish and compete in the global and regional economy.

13. The Government strategies laid out to achieve the policy thrusts and objectives for almost a decade has been the elimination of tariff exemptions, adoption of a harmonized tariff structure with that of other ECOWAS countries, implementation of selective import restrictions as safeguards against unfair trade practices and the dumping of counterfeit and substandard goods, health and cultural reasons as well as to provide temporary protection to firms and industries pending the restructuring and upgrading of their technologies and operations and reduction in high cost of doing business in Nigeria. The provision of leadership in the negotiations of the Economic Partnership Agreement with European Union capped the strategies. Therefore, trade

policy objectives since 2002 seem to have not only remained consistent but have also been augmented, whereas the instruments and the commitment to implementation have not been so certain in view of the character of the evolution of tariffs in the country.

Evolution of Tariffs and Tariff Structure

14. Tariffs can be analysed at the aggregate level as well as at the sectoral level. At the aggregate level, Nigeria's tariff policy has moved between protectionist and liberal stances in the last two decades, this was mainly influenced by movement in development strategies between import substitution industrialisation, and that became the basis of post-independence development strategy, and the Structural Adjustment Programme-stimulated import liberalisation posture of 1986, adopted to re-integrate Nigerian firms into the global business architecture, after the withdrawal of credit lines resulting from the oil glut of the early 1980s.

15. Changes in applied tariffs and outright import prohibition have been the main instruments used to influence the extent of importation. The frequency of changes in these instruments has become the main culprits in the instability of Nigeria's import policy. Tariffs were not excessively high in 1980 but the tariff structure did not feature uniformity across commodity groups. By the time this was being corrected in the 1984 budget, tariff rates were raised culminating in an average tariff of 33% and a range of 10 - 30%. This range implies that the lowest tariff was 10% and the highest 30 percent. An interim tariff regime, pending a more thorough review of the tariff and excise tax structure, instituted in October 1986, reduced average tariff rate to 23%.

16. A new seven-year tariff system introduced in January 1988 to provide a more stable and predictable tariff regime over the medium term, and to rationalise and harmonise Nigeria's tariff rates specified fairly low rates for products abundantly available locally, and higher rates for import-competing products. This however, brought the simple average tariffs in the 1988 – 94 tariff schedules to 33.4%with a range of 0-110%, and a standard deviation of 24.4% which represents fairly wide variations across product groups (Table 1).

17. Another seven-year schedule was introduced in 1995, and was in use until 2001. This schedule aimed at increasing efficiency of domestic industries by exposing them to import competition. In effect, the 1995-2001 schedules reduced the variation of tariffs across products by increasing duties on raw materials, intermediate inputs and capital

goods, while slightly reducing tariffs on final consumer goods. Also, the range of tariff was initially raised from 0-100 percent in 1994 to 0-150% in 1995 but with overall 7 year average of 0-100%. Another feature of the applied tariffs was the presence of international tariff spikes, that is, tariffs greater than 15%. The proportion of lines that were above 15 %was 76.7% in 1988-94 schedule but this proportion reduced gradually but remained high toward 2003. Because most of the tariffs were high, the proportion of the domestic tariff spikes was low, indeed it was zero% in 1988-94, but this increased slightly through 2001after which it rose to 5.2%.

18. Escalation of the tariff structure also featured in both 7-year schedules; as the ratio of average intermediate goods tariff to the average for consumer goods which was 0.49 in 1988 rose to 0.65 in 1994 but fell to 0.55 in 1995 before rising again to 0.66 in 2001. The ratio of the average tariff for capital goods to the average tariff for intermediate goods also oscillated from 0.65 in 1988, to 0.52, 0.54 and 0.64 in 1994, 1995 and 2001 respectively. One feature of tariff policy implementation even during 1988-2001 was the frequent changes made to the pre-announced schedule, against policy intention of ensuring stability and predictability, thus a unidirectional movement towards clear, substantial and sustained import liberalization was not followed in practice. Thus, starting from a low tariff range in 1980, Nigeria began moving towards higher tariffs before 1988. The adoption of import liberalisation policy in 1986 and the subsequent tariff structure was characterised by high tariffs, wide dispersion of tariffs and tariff escalation as well as unpredictability induced by frequent changes.

Table 1: Trend and Characteristics of Nigeria's Tariffs (1988-2008)

	1988-94	1997/98	1999/00	2001	2002	2003	CET 2005/06	percent change (from 2003-2005/06	CET 2008	percent change (from 2005/06 - 2008)
Simple Average tariff rate	33.4	24.4	26	26	29	28.6	12.1	-58	11.6	-4.3
Agriculture (ISIC, Div.1)	34.5	26.7	26.3	26.7	41.5	41.4	12.8	-69	12.6	-1.6
Manufacturing (ISIC, Div 3)	33.3	24.4	26.1	26.2	28.5	28	12.2	-56	11.6	-5.2
Domestic Tariff spikes (per cent of lines)	0.0	0.5	0.5	0.5	5.2	5	1.9	-62	0	-
International Tariff Spikes (per cent of lines)	76.7	51.6	57.9	57.9	57.4	56.5	41.3	-27	41.3	0
Overall Standard Deviation	24.0	18	14.6	14.5	22	22.3	9.1	-59	7.5	-21.3
Range	0-110	0-100	0-150	0-50		0-35				

Source: Trade Policy Review, WTO, 1998, 2005; World Bank (2007), Nigeria Competitiveness and Growth, Country Economic Memorandum; Federal Government of Nigeria 1988. per cent changes computed.

19. In 2003, applied MFN tariff was 28.6%, having resumed an upward trend consistently annually from 24.4 % in 1998, reflecting an increase in the level of overall protection in Nigeria. The country's simple average tariff in 2003 then became higher than the average for sub-Saharan Africa (19.5%), Middle East and North Africa (17.9 %), Asia (11.5 percent) and Latin America (11.2 %). Comparative tariff rates are also lower than that of Nigeria in such African countries as Ghana (12.4 %), Kenya (22.6 %), Uganda (9.0 %), Mauritius (20 %), Senegal (15 %) and South Africa (15 %). Thus, while other countries except Kenya reduced their tariffs between 2001 and 2003, Nigeria increased its own due to pressure from producers (Table 2). Such disparity sustains smuggling into Nigeria.

TABLE 2: SIMPLE AVERAGE TARIFFS IN SELECTED AFRICAN COUNTRIES (2000-2004)

Region/Country	Average Tariff Rate (per cent)	Standard Deviation (per cent)
West Africa		
Benin	12	6.4
Cote d'Ivoire	12	6.4
Ghana	13.1	n.a
Guinea	6.5	2.6
Nigeria	29.1	30.9
Mauritania (2001)	10.6	7.6
Togo	12	6.4
Central Africa		
Cameroon (2001)	18.3	9.6
Gabon (2001)	18.3	9.6
East Africa		
Kenya (2000)	16.3	9.8
Madagascar (2000)	16.2	11.2
Malawi (2001)	13.6	9.3
Uganda (2000)	9	5.4
Tanzania (2000)	16.1	8.8

Source: *Trade Policy Reviews*, World Trade Organization, various years

20. Before the institution of the current structure shown on the last column of Table 1, brought about by the partial harmonisation of tariffs with ECOWAS countries under the Common External Tariffs (CET) in 2005/2006, unstable progress towards more liberalisation characterised Nigeria's tariff regime despite the inducement of SAP evident in the establishment of the two seven-year tariff schedules (1988-94 and 1995-2001) designed to achieve stability and predictability. The structure of the current tariffs is such that it has a simple average of 11.6 %, absence of domestic tariff spike, the existence of 41.3 % international tariff spikes, and an overall standard deviation of 7.5 %. Put differently, these indicators show that though the current CET-compliant tariff schedule features some uniformity and narrow dispersion by virtue of the reduced number of bands to five (0 %, 5 %, 10 %, 20 % and 35 %) there are still many products (almost half of total tariff lines) which carry rates higher than 15 %, the benchmark for international tariff spike.

21. The adopted 5-band tariffs have a range of 0-35 % in contrast to 19 bands and a range of 2.5 % -150 % in 2003, as well as an in-built tariff escalation that has the ratio of

average intermediate goods tariff to the average for consumer goods of 0.36 down from 0.66 in 2001 and the ratio of the average tariff for raw materials to the average tariff for intermediate goods of 0.5 down from 0.64 in 2001. This escalation stems from the tariffs placed on products of category O (0 %) for necessities such as educational materials; category 1 (5 %) for primary raw materials; category 2 (10 % for intermediate products, such as CKD refrigerators, CKD television; category 3 (20 %) for finished goods that are not produced locally and which require no protection, such as television, refrigerators, generators, etc; and category 4 (35 %) for finished goods that are manufactured locally and which require some protection in the interest of promoting local industries[1].

22. Historically, the Nigerian tariff schedule which was simplified in 2005 was partially aligned with the ECOWAS CET, with the maximum rate lowered only to 50 %, well above the proposed ceiling of 20 percent. Nigeria subsequently demanded that ECOWAS should add a 5th band with a rate of 50 % as a condition for participating in the CET. On 23 September, 2008, the Nigerian government approved a new more liberal tariff regime within the CET range of 0, 5, 10, 15, 20 and the 35 % 5th band. The effect of Nigeria's fifth band of 50 %, which was reduced to 35 % and adopted by other ECOWAS members, on particularly WAEMU countries, represented a significant increase in their import protection though a substantial reduction of tariffs for Nigeria.

Sectoral Dimensions of Trade Policy Reform:

Tariff Structure in Agriculture Sector

23. A process of gradual tariff liberalization was evident over the 1988-2001 periods when the average agricultural import tariff rate declined from about 35 % during 1988-94 to 27 % in 1995-2001 (see Table 1). By 2003, average simple applied tariff rates rose to 41.4 % for agricultural products with specific high tariffs (see Table 3) in

[1] Director General of the Budget Office of the Federation in The Guardian, September 26, 2008

such products as fruits and vegetables (98.2 %); tobacco (89.4 percent); beverages and spirits (75.3 %); grains (49.4 %); dairy products (48.1 %); coffee and tea, cocoa etc (44.5 %); live animals and products (34.5 %); and oil seeds, fats, oils etc (34.1 %). Products which attracted above average import tariff rates during 1988-94 include beverages and spirits (86 %) preparation of meat and fish (61 %), fish and crustacean (52 %), cut flowers and products of animal origin (47 %), sugars and sugar confectionary (45 %), dairy products (44 %), preparations of vegetables and fruits (44 %), edible vegetables, roots and tubers (42 %) (WTO, 2005). Nigeria's applied agricultural import tariff rates are much lower than the rates that are bound under the WTO Agreement on Agriculture.

24. At the conclusion of the Uruguay Round, Nigeria undertook bindings for agricultural products at a ceiling rate of 150 % and a maximum of 80 % for other duties and charges across all agricultural sub-sectors or product groups. The difference between the bound and applied tariff rates is high, and provides a substantial space for discretional policy without violating the country's WTO obligations but reduces the credibility of agricultural import tariff policy. With the tariff rates, Nigerian trade policy has been restrictive and gave rise to anti-export bias (WTO, 2005; IMF, 2005:64), because of the association with a very weak export performance, around 3 % of Gross Domestic Product (GDP). While tariffs have fallen across many agricultural products between 1991 and 2003, the average tariff rates in the agricultural sector remained high, hence relatively highly protected.

25. There also exists wide dispersion of tariffs within each product group, with products attracting tariffs of 5 % and others 100 %. With the adoption of the CET, simple average tariff in agriculture fell to 12.6 % in 2008 from 41.4 in 2003.This automatically becomes the MFN applied tariffs at the WTO, and will put pressure on Nigeria to reduce its bound rates in the Doha Round, otherwise the higher difference between bound and applied will further increase the uncertainty around agricultural sector investment. Below is a table showing the summary analysis of the MFN Tariff of 2003.

TABLE 3: SUMMARY ANALYSIS OF THE MFN TARIFF, 2003

Analysis	No of Lines	Applied 2003 Rates				
		No. of Lines used	Simple Average Tariff	Tariff range	Std-dev (per cent)	CV
Agriculture	677	677	50.2	5-150	37.5	0.75
Live animals and products thereof	81	81	34.5	5-100	26.4	0.76
Dairy products	20	20	48.1	5-100	44.0	0.91
Coffee and tea, cocoa, sugar, etc	128	128	44.5	5-100	27.2	0.61
Cut flowers and plants	34	34	20.3	5-65	16.8	0.83
Fruits and vegetables	150	150	98.2	45-100	9.9	0.10
Grains	16	16	49.4	5-100	41.3	0.84
Oil seeds, fats, oils and their products	71	71	34.1	10-100	23.7	0.69
Beverages and spirits	31	31	75.3	5-150	29.8	0.40
Tobacco	9	9	89.4	15-150	62.7	0.70
Other agricultural products	137	137	30.4	5-100	17.8	0.87
By ISIC sector: Agriculture, hunting, forestry and fishing	290	290	41.4	5-100	36.2	0.88

Source: WTO, 2005

26. Non-tariff barriers, essentially import prohibition in the agricultural sector, also imposed to protect domestic industries, reduce balance of payments deficits, and as anti-dumping measures, was placed on wheat flour, sorghum, millet, and kaolin for safeguard reasons, and notified to the WTO committee on Safeguards in 2002. Nigeria has also not implemented any antidumping and countervailing duties since 1998 but has been resorting to import bans as a stop-gap measure for safeguard reasons pending the integration of the World Trade Organization (WTO) Agreement on safeguards into domestic legislation. Recently, the import prohibition list has been expanded to include rice, millet, sorghum and poultry and other meat products, denying domestic producers the necessary competition and consumer's cheaper alternatives (Table 4).

Table 4: Import Prohibitions in Agricultural Sector

Product	HS code
September 2003	
Wheat flour	1001.0000
Sorghum	1007.0000
Vegetable oil in bulk	1507.1100-1516.2000
Cassava and cassava products	0714.1000, 1106.2000, 1108.1400 and 1903.000
January 2004 additions	
Flowers (plastic and fresh)	0603.1000-0603.9000 and 6702.1000-6702.9000
Fresh fruit	0801.1100-0814.0000
Pork and pork products, beef and beef products, mutton, lamb, and goat meat	0210.1900, 1602.4900, 0202.2000, 1602.5000, 0204.4200, 0204.4300, 1602.9000, 0204.1000, 0204.2200, 0304.3000, 0204.4200, 0204.4300, 0210.7900, 0204.5000, 0208.9000, 0210.9900, and 1602.9000
Live or dead birds	0106.3100-0106.9000, 0208.9000, and 0210.9900

Source: WTO, 2005.

27. In view of the restrictive trade in agriculture, the trend of agricultural performance is expected to be upward. Table 5 indicates that between 1982 and 2004, the share of agriculture in GDP and exports ranged between 35% and 40% in the case of agricultural share of GDP and between 2 % and 4 % in the case of agricultural exports as a percentage of total exports. There are also wide variations in the performance of agricultural production and exports over the period. The high restriction on imports could have led to the dismal performance of all the indicators shown on Table 5 as farmers or agricultural producers were shielded from foreign competition which also ensured that they are insulated from beneficial technology transfer and knowledge. In 1986-88 period, share of agriculture in GDP and exports rose to about 42.0 and 4.30 % respectively, this traced to the Structural Adjustment Programme (SAP).

TABLE 5: SHARE OF AGRICULTURE IN PRODUCTION: GDP, IMPORTS AND EXPORTS, 1980 - 2004 (PER CENT)

Indicators	1980-82	1983-85	1986-88	1989-91	1992-94	1995-97	1998-00	2004
Agric output as a per cent of total GDP	35.2	38.6	41.9	39.4	38.1	39.1	40.8	40.2
Agric output as a per cent of non-oil GDP	40.6	45.1	48.1	45.4	43.8	44.8	45.1	45.3
Food imports as a per cent of total imports	15.0	14.0	12.0	7.0	11.0	14.1	14.0	14.2
Agric imports as a per cent of total imports	13.0	12.0	11.0	6.0	9.0	12.0	12.0	11.8
Agric exports as a per cent of total exports	1.9	2.7	4.3	2.1	2.0	1.3	1.4	1.6
Agric exports as a per cent of agric imports	14.0	22.7	7.9	46.0	17.9	9.0	10.5	10.7

Source: Central Bank of Nigeria (CBN), Annual Report and Statement of Accounts

Tariff Structure in Manufacturing

27. The tariff structure in manufacturing shows that between 1988 and 2001, changes in the structure of tariffs occurred in two steps over the seven-year tariff schedule. The simple average import tariff in the manufacturing sector declined from 33.3% during 1988-94 to 26.7% in 1995-2001; In the 1988-94 period, product groups that attracted above average import tariff rates include textiles and wearing apparels (63%), non-metal products (47%), leather products (37%) and transport equipment (35.3%); while paper products (20%), chemicals (25%) and metal products (28%) attracted below average tariffs. During 1995-2001, the product groups which attracted above average tariff rates included textiles, weaving apparels, and non-metal products (40%), leather products (37%), and rubber products (34%); while those with below average tariffs were paper products (12%), metal products (21%) and transport equipment (26%). Among the major product groups, only rubber products experienced an increase (20 %) in average import tariff between 1988-94 and 1995-01. All other product groups experienced declines in average tariff rates over the same period with

the following achieving sharper than average decreases: paper products (38%), textiles and clothing (37%), transport equipment (26%), and metal products (24%).

28. The sectoral composition of the MFN tariffs in 2003 presented in Table 6a also indicates wide differences. For instance, the average applied MFN tariff rate by product group in the non-agricultural products range between 2.5% - 45% (non electric machinery and machinery), 2.5% -100% (wood, pulp, paper and furniture, chemicals and photographic supplies), (5% – 50 % (leather, rubber, footwear and travel goods), 5% - 65% (metals, textiles and clothing), and 5% -100% (mining and quarrying, raw materials). In addition, there exists wide dispersion of tariffs within each product group as woods, pulps, papers and furniture's attract tariffs of 2.5%, others within the group attract rates of 100%, although the average for the group is 27.0%. The highest simple average tariff rates are found in the textiles and clothing with a rate of 42.7%. This is followed by mineral products, precious stones and metals (29.8%), leather, rubber, footwear and travel goods (28.9%), fish and fishery products (28.0%) and wood, pulp, paper and furniture (27.0%). Non electric products (13.9%), chemical and photographic supplies (17.7%) however recorded the lowest average tariff rates.

29. The simple average tariff for manufacturing under the CET fell from 28% in 2003 to 11.6%. The percentage change from 2003 to 2005/06 for manufacturing sector is 56 percent and has fallen further in the 2008 tariff schedule by 5.2%. In contrast, agricultural tariffs fell by more percentage points (i.e. 69%) between 2003 and 2005/06 tariffs than manufacturing tariffs (56%). These changes in respect of the two sectors are large tariff reductions under which firms and farms were operating. They need to be mitigated through certain measures to cushion the effect it would have on the players.

TABLE 6A: SUMMARY ANALYSIS OF THE MFN TARIFF, 2003

Analysis	No. of lines[2]	Applied 2003 rates					Imports 2000 (US$ million)
		No. of lines used	Simple avg. tariff (percent)	Tariff range (percent)	Std-dev (percent)	CV	
Total[3]	5,146	5,124	28.6	2.5-150	22.3	0.78	5,804.5
By WTO definition							
Non-agriculture (excl. petroleum)	4,467	4,445	25.3	2.5-100	16.7	0.66	4,782.6
Fish and fishery products	108	108	28.4	5-100	25.0	0.88	257.7
Mineral products, precious stones and precious metals	340	340	29.8	2.5-100	18.8	0.63	495.2
Metals	591	589	22.4	5-65	12.1	0.54	552.7
Chemicals and photographic supplies	844	842	17.7	2.5-100	14.9	0.84	969.5
Leather, rubber, footwear and travel goods	146	146	28.9	5-50	8.9	0.31	62.3
Wood, pulp, paper and furniture	249	248	27.0	2.5-100	20.3	0.75	298.0
Textiles and clothing	832	824	42.7	5-65	11.3	0.26	73.4
Transport equipment	137	135	19.1	10-55	12.3	0.64	724.7
Non-electric machinery	526	521	13.9	2.5-45	7.4	0.53	710.4
Electric machinery	258	258	20.0	2.5-45	8.4	0.42	511.1
Non agricultural article n.e.s.	436	434	23.0	5-100	14.7	0.64	127.6
By ISIC sector[4]							
Mining and quarrying	108	108	17.9	5-100	15.4	0.86	30.5
Manufacturing	4,747	4,725	28.0	2.5-150	21.0	0.75	5,477.6
By stage of processing							
Raw materials	633	633	32.2	5-100	31.2	0.97	741.5
Semi-processed products	1,679	1,676	24.5	2.5-100	16.5	0.67	1,930.3
Fully-processed products	2,834	2,815	30.2	2.5-150	22.6	0.75	3,132.7

Note: CV = coefficient of variation.
Source: WTO Trade Policy Review, Nigeria (2005).

Non-Tariff Barriers

30. A key characteristic of the Nigerian import regime is the frequency of non-tariff barriers, including import prohibitions or bans. Under Nigeria's customs legislation, import prohibitions can be applied to protect domestic industries; to reduce balance-of-payments deficits; as anti-dumping measures; and for moral, safety, and other purposes. The Government modifies the import prohibition list, adding or subtracting items, through notices and decrees (WTO, 2005). Import prohibitions remain the major source of non-tariff barrier in the country.

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[2] Total number of lines is listed. Tariff rates are based on a lower frequency (number of lines) since no rates were provided for 22 tariff lines

[3] Two tariff lines are excluded from WTO non-agriculture definition (essentially petroleum products)

[4] International Standard Industrial Classification (Rev.2). Electricity, gas and water are excluded (1 tariff line)

31. In terms of sectoral coverage, import prohibition has focused on such agricultural products as fruits, vegetables, grains, meat and fish, as well as manufactured products, including rubber, wood and cork, textiles, and chemicals. Based on the customs legislation, the government placed 76 broad groups of import items on the import prohibition lists in 1978. The number of items placed under import prohibition increased further during 1982-1985. Hence, at the beginning of 1986, about 40% of agricultural and industrial products, in terms of tariff lines, were covered by import prohibitions. This sharp increase in the coverage of import prohibitions abated somewhat during the second half of the 1980s; by 1989, import prohibition covered about 29% of agricultural products and 2% of industrial products measured, again, in terms of tariff lines (GATT, 1991). In 1989, for example, close to 96% of the tariff lines for textiles and clothing were subjected to an import prohibition regime; with similar coverage ratio for several other sectors being as follows: furniture (93%), wood and work (45%), rubber (5%), and chemicals (1%) (GATT, 1991). During 1982-1985, the import prohibition coverage ratio for food, beverages and tobacco was over 50%.

32. The list of products prohibited in 1989 became elongated in 1991 with additional products added, reaching up to 20 broad items on the absolute import prohibition list and 15 items on the conditional prohibition list that features such products as poultry products, vegetables, wood, fruits textile fabrics, beverages, maize, wheat, used tyres, among others. From 11 broad products in 1998, the number of prohibited items rose to 46 in 2007, but fell to 23 in 2008. Nigeria's non-tariff measure frequency ratio was 12% in 2004 compared to 7% and 5% averages for ECOWAS and Sub-Saharan Africa respectively. Although tariffs have declined somewhat since 2002, the number of products subject to import bans has increased significantly. The import prohibition list has also been unstable as products found their way in and out of the list. Usually, the list covers a wide range of goods whose only common trait is that they compete with domestic Nigerian manufacturing and agricultural products. The extent to which the bans are enforced varies and exemptions are sometimes granted.

33. Given the trend of tariffs and import prohibitions, both appear to be the most problematic trade policy instruments in terms of their management, regularity, compliance to multilateral rules and economy-wide effects, particularly welfare effects in Nigeria. While these undermine poverty reduction objectives and anti-smuggling

campaign of the Government, the efficiency in the allocation of the country's resources is in doubt. In finding justification for changing these two, Nigeria has consistently referred to trade remedies even without appropriate notification to the relevant WTO Committees or without the existence of appropriate enabling domestic law. Examples include relating the countries' high tariffs and import prohibitions to anti-dumping and countervailing measures, as well as safeguards and balance of payment measures when there is no multilaterally-compliant legislation in existence. Therefore, in April 1982 for instance, when a wide range of products were placed under import prohibition, the Nigerian Government notified the measures taken to the GATT with the claim that the measures had been necessitated by unfavourable external circumstances, including a deterioration of the terms of trade, and sharp declines of the country's oil revenue and foreign exchange reserves.

34. Similarly, in March 1998, Nigeria notified the WTO Committee on Safeguards that the import prohibitions on wheat flour, sorghum, millet; gypsum and kaolin were imposed for safeguard reasons. These reasons do not justify the almost permanent ban on the importation of textile and clothing products since the late 1970s which can only be explained primarily in terms of protecting local industries while the import prohibition applying to such items as gypsum, kaolin, bentonites, and barytes reflect attempts to promote local sourcing of raw materials for manufacturing in Nigeria.

35. Currently, at the sectoral level, bans are most prominent in the following product groups: footwear/headgear (73% of tariff lines banned), textiles (62%), raw hides, skins, leather and furs (32%), vegetable products (31%), foodstuffs (30%), transportation (26%), animal and animal products (23%), plastics and rubbers (6%), wood and wood products (6%), and machinery and electrical products (5%). Recently, some of the prohibited products have included cement in bags, toothpicks, exercise books, textiles, soaps and detergents among others. Some of these products include arms, certain categories of spirits, textile materials that contains hazardous chemicals, obscene articles, banned on security, health and morality grounds. In addition, the law forbids the importation of vehicles of a particular age, drugs, cement and all containerized goods through Nigeria's land border. In certain circumstances, Nigeria still makes use of specific licensing requirements for a number of restricted products such as petroleum products and generators.

36. Replacing all the bans with a 35% tariff in 2006 would have increased Nigeria's total imports by $2.4 billion (or about 10 percent of official imports) and raised tariff revenue by $840 million (or about 12 percent of non-oil government revenue). The major product groups whose imports would have risen include used motor vehicles ($500m), medicaments ($379m), African print fabrics ($309m), yarn ($262m), vegetable oils and fats ($233m), maize, millet, sorghum ($164m), and wheat flour, maize flour, cereals, etc ($123m)[5] (Table 6b).

37. Government policy credibility is additionally put at stake when divergence between policy statements and policy actions is commonplace. For instance, in one policy statement the Nigerian government submitted to the WTO in 1998, it indicated that, "the list of items removed from import prohibition ... continues to lengthen" (Para. 14), and that "necessary steps are being taken by government to comprehensively eliminate all existing items on the import prohibition list as soon as possible" (Para. 17). Towing the same lines, President Olusegun Obasanjo's foreword to the Trade Policy of Nigeria (2002) envisages a "dynamic trade reorientation which will signify a clear departure from past regimes of controls and intervention". Furthermore, this document affirmed (on p. 10) that "Government shall, within the limits of its rights and international obligations and agreements, strive to eliminate quantitative trade measures". In practice, however, import bans actually increased in scope and coverage until 2004.

38. Nigeria's relative restrictive trade policy in West Africa has engendered persistent smuggling between it and neighbouring countries, and few systematic analysis of how the tariff differences and import prohibitions have influenced smuggling has been conducted. Smuggling and related corruption are economic implications of highly restrictive control on economic activity. According to economic principles, whenever a control is established at a point in the value chain to distort the working of the price mechanism, particularly since the rationing and monitoring system cannot be efficient, economic agents will withdraw the economic transaction from official to unofficial arena thus growing the underground economy. In the context of high tariffs and import prohibitions on cross-border flow of goods, smuggling is the underground economy that

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[5] Andriamananjara, S., J. Von Uexkull, P. Brenton, P. Walkenhorst, and L. Hinkle, (2008), Quantifying the Potential Impact of an EPA on Nigeria, World Bank, Abuja. September.

booms. In an attempt to make effective the fight against smuggling, confiscation of smuggled goods has been extended from the borders to within the customs territory, representing a new dimension in the fight against smuggling[6].

Table 6b: Observed Imports under Ban Categories And Indicative Import Response to Replacing the Import Bans with A 35 Percent Tariff Rate, 2006, Top 20 Most Affected Categories, Us$ Million

Ban category	Observed imports	Predicted imports	Response to lifting the ban
Total	1,828	4,236	2,408
39 - Used Motor Vehicles above eight (8) years from the year of manufacture	402	903	501
20 – Medicaments	361	739	379
32 - African print fabrics, Carpets, Lace Fabrics, Towels	409	719	309
33 – Yarn	15	277	262
9 - Vegetable Oils and Fats	9	242	233
7 - Maize, Millet, Sorghum	4	168	164
8 - Wheat Flour, Maize Flour, Cereal Groats, Meal and Pallets	4	127	123
2 - Pork and Pork Products, Beef and Beef Products, Mutton, Lamb and Goat Meat	3	87	83
1 - Live or Dead Birds including Frozen Poultry	1	84	83
42 – Furniture	28	64	36
27 – Toothpicks	18	52	33
38 - Used Air-Conditioners, Compressor and Fridges/Freezers	130	160	31
6 - Fresh and Dried Fruits	2	27	25
35 - Foot Wears and Bags including Suitcases of leather and plastics	76	95	19
17 - Beer [Bottled, Canned or otherwise Packed]	2	20	17
23 - Finished Soaps	39	56	16
24 - Disinfectant, Germicides, Mosquito repellents	26	42	16
34 - Exercise Books	0	14	13
40 - Fully built and CKD Bicycles Frames, Forks and Mudguards	15	24	9
3 - Birds Eggs	2	10	8

Source: Andriamananjara, S., J. Von Uexkull, P. Brenton, P. Walkenhorst, and L. Hinkle, (2008), Quantifying the Potential Impact of an EPA on Nigeria, World Bank, Abuja. September.

39. However, in view of Nigeria's experience, this would only widen the corruption network, violating the zero-tolerance of corruption of the 7-ponit Agenda. Another recent study quantified the extent to which Nigeria's restrictive trade regime promotes

[6] The Nigeria Customs Service boss, Mr Ahmed Mustapha, informed that NCS officers were prepared to invade markets, raid shops and confiscate smuggled items to comply combat smuggling and confiscate all banned textiles and fabrics from supermarkets, markets and other public places where they are displayed for sale – The Guardian September 26 2008.

smuggling and reduces government revenue from import duties[7]. According to this study, the trade regime, which is characterized by numerous import bans and tariff peaks provide opportunities and incentives for smuggling, corruption and a non-compliance culture which obstruct Customs modernization and trade facilitation. The study estimates that about $US4 billion of goods, representing 15per cent of total imports, are smuggled to Nigeria from Cotonou port only while about US$400 million or 25 % of current import duties could be collected on top of current revenues if the trade restriction is adjusted to the current practices in the sub-region. Added to these problems are port traffic diversion and delays in port clearance.

40. An indication of the impact of high tariffs and import prohibitions on prices is provided in a study that assessed the level of protection in Nigeria, by comparing wholesale prices of selected fairly homogeneous products grouped according to their degree of protection in Nigeria with those prices prevailing in Benin, Togo, and Niger, focusing on the extent to which differences in official tariffs and other charges could explain the differences in prices of selected products in these countries. The evidence indicates that there exists a quite striking degree of wholesale price differences between Nigeria and its neighbouring countries, Benin, Niger and Togo. Using wholesale prices obtained from field survey in June 2008, the wholesale price of all selected prohibited items, with the exception of bottled water and beer, are more expensive in Nigeria than in Benin.

41. The wholesale prices of frozen chicken, cooking oil and bagged cement are higher in Nigeria than in Niger while only maize, bottled water and beer prices are lower in Nigeria than in Togo (See Table 7). Nigeria's wholesale prices of frozen chicken and cooking oil are highest of prices among the four countries. The more striking difference is obtained with respect to bagged cement where the wholesale price in Nigeria is highest with the extent of difference as high as over 80% compared with Benin and Togo. On the average, Nigeria has higher wholesale prices in cassava, spaghetti, cement and the notoriously smuggled frozen chicken and cooking oil. Interestingly, smuggling did not smooth the price differential created by the higher tariffs and import

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[7] Raballand G. and E. Mjekiqi (2008), Nigeria's Trade Policy facilitates Unofficial Trade and Impacts Negatively Nigeria's Customs Efficiency and Economy, A Report by the Africa Transport Unit, The World Bank.

prohibitions perhaps due to costs of smuggling and the high risk involved. The implication is that removing the goods from import prohibition list and their 'tariffication' will increase Government revenue as shown by above analysis. Of the high-tariff products which carry tariff rates of as high as 20 % and 50 % rice, sugar and cigarettes are known to be highly smuggled across the Nigerian and neighbouring countries' borders, while their wholesale prices are higher in Nigeria. For rice, the difference is over 100 percent between Nigeria and Benin, while sugar's margin is 31.6 %, both being sufficiently high to attract unofficial imports from Benin. Prepared/preserved tomatoes also have a very high wholesale price difference.

42. Industrial protection should in principle aid domestic production and prepare domestic producers for eventual import-competition and if very successful, engage in export. The relationship between protection through tariffs and domestic industrial production between the two 7-year tariff schedules of 1988-94 and 1995-2001, chosen for data consistency, is tested by putting industrial capacity utilization side by side nominal tariff rates and real effective tariff rates which incorporates tariffs on raw materials of particular industry in Table 7 below.

TABLE 7: COMPARISON OF AVERAGE CURRENT WHOLESALE PRICES (US$) - BENIN, NIGER, TOGO, AND NIGERIA, JUNE 2008

	Benin	Niger	Togo	Nigeria	Percent diff Nigeria-Benin	Percent diff Nigeria-Niger	Percent diff Nigeria-Togo	Average percent diff across countries
Prohibited Items								
Maize (100kg)	62	95	112	70	12.9	-26.3	-37.5	-17.0
Cassava (50kg)	21		17	43	104.8	Na	152.9	128.9
Frozen Chicken (10kg)	30	8	30	47	56.7	487.5	56.7	200.3
Cooking Oil ((25l)	30	45	42	56	86.7	24.4	33.3	48.1
spaghetti (10kg)	11	18	15	15	36.4	-16.7	0.0	6.6
Mineral water (19kg)	22	5	8	4	-81.8	-20.0	-50.0	-50.6
beer (60cl x 12 bottles)	19		14	13	-31.6	Na	-7.1	-19.4
Bagged cement (1 tonne)	164	179	162	298	81.7	66.5	84.0	77.4
High tariff Items (20per cent and 50per cent)								
Rice (50kg)	33	46	71	71	115.2	54.3	0.0	56.5
Sugar (25kg)	38	42	42	50	31.6	19.0	19.0	23.2
cigarette (50 x 10 x 16)	639	833	641	715	11.9	-14.2	11 5	3.1
Prepared/preserved tomatoes	9	11	n.a	25	177.8	127.3	Na	152 5
Concentrated Unsweetened milk 48 x 170g	28	26	25	30	7.1	15.4	20.0	14.2
Low tariff items (5per cent and 10per cent)								
Sweetened milk (box of 48 x 78g)	42	44	40	43	2.4	-2.3	7.5	2 5
Soap 60 x 190g	17	20	17	38	123.5	90.0	123.5	112 4
Candle (carton)	43	21	37	37	-14.0	76.2	0.0	20 7
Lipton tea (2.4kg)	n.a	18	23	58	n a	222.2	152 2	187 2

Source: Oyejide et al, 2008 Study prepared for World Bank on wholesale prices in Nigeria, Benin, Togo and Niger.

43. As can be observed from the data, rather than for protection to render Nigerian firms ready for import competition, tariff reductions during 1988-2001 affected the production capacity utilization negatively. Secondly, there is no systematically strong relationship between Nigeria's tariff policy and its industrial capacity utilization. For example, while the largest reduction in the average effective rate of protection in machinery and equipment sector is associated with the largest increase in capacity utilization rate, the largest increase in the average effective rate of protection of the rubber products sector is linked to the largest reduction in capacity utilization rate. The textiles sector, which experienced reduction in average effective rate of protection of 12%, has its capacity utilization rate falling by as much as 25%, almost at an equal rate with paper products sector which has a reduction of 23% in average effective rate of protection.

44. Finally, these different reductions in protection rates that are linked to varied responses in capacity utilization rates suggest that such other factors as lack of competitiveness due to inclement production environment induced by worsened situation of economic infrastructure, technological underdevelopment, managerial and management challenges, smuggling of highly protected products, lack of competition policy, inadequate intellectual property rights protection, discouraging investment environment, among others are indeed important in determining industrial output growth. The textile sector, in particular, has enjoyed more protection in the manufacturing sector by virtue of additional import prohibition habitually used to protect the sector.

45. A survey conducted for the World Bank on the impact of trade liberalization and Nigeria's textile industry in 2003 revealed that production machinery in the sector was antiquated, with the age of machinery averaging 19 years while the last time a new machine was installed was an average of over 5 years[8]. Moreover, the sector did not demonstrate adequate creativity and innovation required to meet changing consumer preferences manifested in the slow introduction of new designs into the market. Therefore, against the background of using current domestic firms' protection to generate future technological growth, exports and industrial diversification as predicted by the principle which justifies protection, shielding Nigerian firms from initial import competition by virtue of regarding them as infant industries has not worked as envisaged but has only created few gainers and large losers around trade policy. The losers have been consumers, importers and traders as well as Government when no revenue is collected because of prohibition.

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[8] Oyejide, T. A, Ogunkola, E. O., Adeninkinju A. Jerome A, and Bankole, A. S., (2003) The Impact of Trade Liberalisation on Nigeria's Textile Industry, Report prepared for the World Bank, Abuja.

TABLE 8: AVERAGE CAPACITY UTILIZATION AND TARIFF RATES COMPARED

	Average Capacity utilization			Average Nominal Rate of Protection			Average effective rate of protection		
	1988-94	1995-2001	Diff per cent	1988-94	1995-2001	Diff per cent	1988-94	1995-2001	Diff per cent
Food Beverages and Tobacco	34.4	27.5	-20	66.8	66.7	-0.1	100.5	96.7	-3.8
Textiles	47.4	35.8	-25	63.4	40.1	-36.8	82.6	72.9	-11.7
Leather	45.9	38.6	-16	36.8	36.6	-0.5	119.0	110.2	-7.4
Wood Products	44.7	36.5	-18	33.0	28.9	-12.4	130.3	120.1	-7.8
Paper Products	40.9	30.2	-26	19.6	12.1	-38.3	33.0	25.3	-23.3
Chemicals	42.4	38.5	-9.2	24.6	22.2	-9.8	52.7	45.5	-13.7
Rubber Products	45.6	30.9	-32	28.3	33.9	19.8	83.9	92.3	10.0
Metal products	40.4	41.9	3.73	27.6	21.0	-23.9	87.7	73.4	-16.3
Non-metal products	40.2	34.6	-14	47.3	40.1	-15.2	115.6	112.3	-2.9
Machinery and Equipment	30.1	41.4	37.7	35.3	26.1	-26.1	207.1	150.4	-27.4

Source: 1) Adeninkinju A. 2005, *African Imperatives in the New World Trade Order: Country case Study of the Manufacturing Sector.* Trade Policy Research and Training Programme, Department of Economics, University of Ibadan, and African Economic Research Consortium, Nairobi, Kenya; 2) Bankole A.S., 2004. Nigeria's Industrialisation Strategy under Multilateral Agreements" in Annual Conference of the Nigerian Economic Society NES. (ed.), Ibadan.

46. Evidence in support of this can be found in the reaction of other economic participants other than producers. The policy of import prohibitions has several negative effects in the perception of importers and traders of a wide range of products on the import prohibition list. The Refrigerator and Air Conditioner Dealers Association (RADA), in its statement, "condemned the ban on importation of these products because it would lead to substantial losses of income and jobs, and further aggravate the unemployment situation"[9]. In the same vein, the Motor Dealers Association of Nigeria (MODAN) issued a statement which argued that "the ban on used vehicles would destroy four million jobs"[10] while according to the Embroidery Lace Dealers Association of Nigeria (ELDAN), "an immediate enforcement of the ban on importation of textiles would inflict colossal financial loss on textile imports and eliminate three millions jobs"[11].

47. On the other hand, the domestic producers of banned imports and the workers' unions associated with them not only generally lobby government to impose and maintain its import prohibition policy but also articulate its advantages. Therefore, in its

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[9] See *The Guardian*, October 2001

[10] See *The Guardian*, December 2001

[11] See *The Guardian*, March 2004

reaction, the National_Association of Cottage Industrialists of Nigeria (NACIN) urged the Government to "ensure strict implementation of the ban on imported products as a means of guaranteeing the survival of small and medium scale enterprises and to create employment for the nation's teeming graduates"[12]. The Manufacturers Association of Nigeria (MAN) pushed this point of view further by "proposing a minimum life span of five (5) years for the current import restrictions policy as a means of ensuring that it achieves the desired results"[13]. Finally, the National Union of Textile, Garment and Tailoring Workers of Nigeria (NUTGWN) "considered the textile ban as the best development in the textile industry in recent times because of its beneficial impact on local output and employment"[14]. It is instructive to note that import policy especially as it relates to textile has deviated substantially from the general objective of trade policy laid down by the Government itself as most textile imports except baft have been prohibited from entering the country, even though many waivers have also been granted to powerful interests by the Government.

48. Nigeria's use of import prohibitions as a trade policy instrument has been a source of friction with its trading partners; this practice has also been repeatedly condemned for its inconsistency with GATT and WTO rules and by countries whose exports were affected. For example, Norway formally complained on Nigeria's import ban on stockfish, United States on the import ban on wheat and rice, and Côte d'Ivoire on the import ban on textiles. The first two cited violation of GATT rules in their complaints while the third cited treaty violation of the Economic Community of West African States (ECOWAS). The EU also argued that "Nigeria's import ban was not compatible with, and indeed forbidden, by WTO rules[15]". Another country in West Africa, Republic of Benin, also claimed that "Nigeria's import bans, particularly on textile

[12] See *The Guardian*, Feb. 2004
[13] See *The Guardian*, March 2004
[14] *The Guardian*, April 2004

[15] Claude Maerten, an official of the EU Trade Directorate-General, in *The Guardian* ,July 2003

products, had left a severe blow on the economy of the Republic of Benin" and "constituted a violation of the Memorandum of Understanding between the two countries regarding continuous trade liberalization"[16]

49. Despite World Bank's lending programme to promote trade liberalization[17] through the reduction and eventual elimination of import prohibition, Nigeria had, in general, displayed a poor implementation record and commitment to import liberalization[18]. World Bank in its assessment of Nigeria's trade policy reform noted that the SAP's attempts to achieve transparency and stability in the incentive system were overtaken by events[19]. The WTO itself has engaged Nigeria in various discussions regarding its import prohibition lists and, both in 1996 and 1998; the WTO Committee on Balance of Payments Restrictions decided that Nigeria's import prohibitions could not be justified under the balance of payment rules of GATT 1994 and WTO rules[20].

50. In Nigeria, the process has been blamed for the trend of tariffs and import bans. This is summarized in a recent statement by Olusola Faleye, President of the Lagos Chamber of Commerce and Industry[21]that "We have no query with the principles of protection, but with the process. We are concerned that the recent import prohibition policy was not preceded by sufficient consultation. He added that import prohibition is a major trade policy decision which requires wide ranging consultations, capacity surveys and the advice of trade and economic development experts before being pronounced as policy. Sufficient consideration was not taken into account of the local capacity vis-à-vis local demand and issues of policy transitions and implications for existing treaties to which Nigeria is signatory"

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[16] Benin's Ambassador. Benoit Adekambi's statement in *The Guardian*, November 2003

[17] The Trade Policy and Export Development Loan of $450 million of 1987, and the Trade and Investment Policy Loan, of $500 million in 1989 (World Bank, 1994)

[18] Castillo, G. (1993) "TEP Study on Trade Policy Reforms in Sub-Saharan Africa The Case of Nigeria", *Mimeo*, World Bank, Washington, D.C.

[19] World Bank (1994). *Structural Adjustment Program: Policies Implementation and Impact*, Report No 13053 – UNI, Country Operations. Western African Department, World Bank, Washington, D.C

[20] Nigeria first invoked GATT Article XVIII:B on import restrictions for balance of payments reasons in 1982 This led to the first consultation with the GATT Committee on Balance of Payments Restrictions in April 1984. In notifying its import restriction measures to the GATT in April 1982, Nigeria emphasized their temporary nature. The Committee encouraged Nigeria to pursue more appropriate economic stabilization policies

[21] See *The Guardian*, April 2004

ToR 2: ***Review of existing studies on the tariff structure, with particular focus on its impact, limitations and mitigation measures.***

Impact of Current Structure of Tariffs

51. The current structure of tariffs may be viewed as offering inadequate protection to Nigerian producers given the initial tariff average rates in 2003 and the average rates at the time of the partial adoption of the CET. According to the data on Table 1, the simple average tariff for all products dropped by 58 % while it fell for agricultural products by 69 % and for manufacturing by 56 %. This implies a reduction in nominal protection for Nigerian producers by at least those corresponding rates, though there could be variations regarding how it affects particular subsectors. In principle, any such large reduction in protection will entail adjustment costs on the part of producers that have to be mitigated, particularly the loss of market share as imports increase. It also entails that the nature of the adjustment costs and how producers are affected need to be well understood through detailed impact analysis of the reduction of protection on domestic farms and firms.

52. The impact of frequent changes to how trade policy instrument are used may be analyzed from two important perspectives. First, is the impact that the adoption of CET brought to bear on the tariff structure itself. The second is the impact it has on the Nigerian economy via revenue, output, investment and growth implications.

53. In the case of the first, the impact of the CET on Nigeria's tariff structure could be regarded as quite beneficial overall as it has reduced the maximum tariffs to 35per cent from a high of 150 %. Secondly, the tariff band has been narrowed to only five from about nineteen thus making the job of port clearance easier to facilitate trade and customs administration. Thirdly, many tariff lines in the CET carry low and uniform tariffs, which reduce the wide tariff dispersion that was a common trait of past tariff schedules. Fourthly, the current structure has narrowed the differences between Nigeria's trade taxes and those of its neighbours, a development that is expected to impact positively on smuggling activities, if other port charges and institutional frameworks are also streamlined. Fifthly, the structure has the ability to strongly discourage the use of waivers and concessions, attendant high restrictive regimes and thereby foster transparent trade policy administration and management.

54. Other benefits of the current tariff structure include; market enlargement for Nigerian producers, increase in economic integration, increased foreign exchange earnings from non-oil exports, improved productivity and related growth induced by rising capital accumulation, and a stable and predictable tariff regime required for investors and even traders to seriously consider the country in their business decisions. Also, the current structure has the potential to contribute to Government's effort to reduce poverty which has been counteracted by the high degree of protection in agriculture and non-agriculture products.

55. In terms of the second mechanism through which the impact could be assessed, one study assessed the impact of ECOWAS adoption of the UEMOA four-band tariffs of 0 percent, 5 percent, 10 percent and 20 percent on Nigeria's fiscal revenue and trade balance[22], with the findings that the adoption of UEMOA tariffs and sundry charges could lead to a loss of 6.9 % of total Government revenue or 8.8 %, if exemptions are considered. If these rates are viewed in terms of 2002 total Government revenue of N1,713.8 billion, this loss represents about N119 billion or N152 billion. According to the study, incorporating accompanying measures, such as efficiency of tariff revenue collection, elimination of exemptions, simultaneous application of VAT, and the expected increase in imports, the revenue loss could reduce to 2.9 % of total Government revenue or N50.2 billion. For the trade balance, it would likely deteriorate by between 3 % and 6 % of GDP representing between N233.8billion and N467.7billion at 2002 GDP current prices; and if interpreted as imports replacing domestic production, the figures indicate a reduction of domestic output by those amounts.

56. The study suggests that this deterioration could however be addressed by exchange rate depreciation that will eventually reduce imports and make exports attractive in the long run. Though the study was only able to infer real sector impacts from the potential upsurge in imports which will increase competition for domestic industries, it pointed to the whole of ECOWAS market that will be available to Nigeria,

[22] Soludo C.C., Okey G. Oji, and Chukwuma Agu (2003) Potentila Impacts of Extension of UEMOA Tariffs to all ECOWAS Member States. A Case study of Impacts on Revenue and Trade Balance in Nigeria. Report of the African Institute for Applied Economics, Enugu

- the support of the organized private sector for the UEMOA tariffs on raw materials and capital goods but not final goods, and the impending economic partnership agreement (EPA) with Europe, as the positive opportunities that exist for Nigeria in the event that the UEMOA tariffs are adopted. Between the time of the study and now, Nigeria has been able to convince other ECOWAS members to adopt a fifth band of 35 % to guarantee protection of ECOWAS producers and undesirable reduction of Government revenues. Such modification will undoubtedly moderate the above-mentioned impacts.

57. Another study of the impact of the CET on Nigeria concluded that though the CET will only a very small negative impact on the Nigerian economy, the main consequence is the tariff reduction effect while it is expected to be beneficial to the manufacturing sector, in terms of volume of trade and absorption of labour and ensuring consumers' welfare. The loss in terms of value of production, and probably profit, can be explained by the inefficiencies in production infrastructure, inadequate access to credit, insufficient demand and policy uncertainty in Nigeria[23].

58. The agreement by other ECOWAS members to adopt the 5th band is not without costs. One such cost relates to the violation of WTO rules by these countries, the nature and extent of which is indicated on Table 9. The table shows that the tariff rates for at least 23 products will increase in violation of WTO rules because of the agreement to Nigeria's 5th band of 35% and the countries should be prepared to pay compensation to any country which raises a point on these according to paragraph 6 of article XXIV:

> *If, in fulfilling the requirements of paragraph 5 (a), a contracting party proposes to increase any rate of duty inconsistent with the provisions of article II, the procedure set forth in article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.*

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[23] *O. Alaba, A. Adenikinju and P. Collier* (forthcoming), Trade Policy: Prospects and Challenges in P. Collier, C. Pattilo and C. Soludo, (eds.)

TABLE 9: NUMBER OF PRODUCTS VIOLATING WTO BOUND TARIFFS ON THE ADOPTION OF 35% 5TH BAND

Country	Number of Products
Benin	23
Burkina Faso	23
Cape Verde	101
Cote d'Ivoire	28
Guinea	23
Guinea Bissau	0
Mali	23
Niger	23
Senegal	95
Sierra Leone	0

Source: CARANA (2008), Draft studies for the Finalization of ECOWAS Common External Tariffs (CET), May.

Limitation of Current Structure

59. The first limitation of the current structure is that it may not offer sufficient protection to domestic industries on account of subsisting production environment in Nigeria, particularly the inadequacies of economic infrastructure, and the effect of smuggling, which unfortunately, is also an outcome of too high protection. Therefore, the policy challenge remains how to balance the need for protection with the social economic rights of all citizens which indeed is a fundamental human right. One way out is to address appropriate policy instruments to the targets that they are best suited in order to achieve optimal solution, following the instrument-target rule[24]. Therefore, tariff policy should not be expected to resolve infrastructure and management problems and other challenges that have been mentioned.

60. The second limitation constitutes in the irreversibility of the current structure due especially to its manner of evolution. Apart from being designed within the regional integration framework of ECOWAS, it is believed to have been designed with the consultation of the private sector. Apart from this, the current structure embeds a compromise between Nigeria and the rest of the ECOWAS countries in West Africa. As argued earlier, many countries are in violation of WTO rules by agreeing to the 5th band of 35%. This also ensures the irreversibility of the current tariff structure. Even if it were

[24] Tinbergen, J (1952), *On the theory of economic policy,* Amsterdam: North Holland; Mundell, R. A. (1968), *International economics*, London: Macmillan.

possible, the required negotiating capital is huge and therefore will not be a simple and uncomplicated task.

61. The third limitation of the current tariff structure is the general loss of trade policy sovereignty by member countries as regional institutional arrangements subdue national trade policy-making. In addition, domestic stakeholders particularly producers lose their power to lobby trade policy in their favour, this being potentially beneficial for government's fiscal health, consumers and traders. Finally, any import surge that results from the current structure will put pressure on the real exchange rate and make imports of raw materials and machinery more expensive. Notwithstanding this, the export sector could respond positively to the exchange rate depreciation or elastic imports could contract as a result.

Available Mitigating Measures

62. As discussed above, the reduction of average tariffs from the levels in 2003 to the CET level in 2005/06 was quite large, almost 60% on average. Generally, it is expected that a carefully planned phased liberalization should not involve shock to the economy's production systems. That is why one of the significant ways to lessen the impact of tariff liberalization is to adopt a gradualist approach to liberalization mostly favoured because the implementation of complementary or compensating measures take longer gestation period. In the case of Nigeria, this phased liberalization would have been implemented from 1988 if not for the reversal of the trend of the 7-year tariffs in 2001/2002 when at expiration of the 1995-2001 tariff schedules, the authorities resorted to ad-hoc tariff fixing and increments by bowing to pressure from producers. At the same time Nigeria had to speed up the integration process in the ECOWAS region an effort that led to its abrupt adoption of the CET in 2005/2006[25]. In view of the fact that the CET has been adopted and implemented for almost 4 years, there is a need for an assessment of its impact on industrial and agricultural production.

[25] The Federal Ministry of Finance claimed it had consultations with the organized private sector and agreed on the rates before the adoption (Federal Ministry of Finance (2009), The Common External Tariffs (CET) Issues, Policy and Way Forward – Background Paper to Presentation made by the National Economic Management Team to Presidential Steering Committee on Global Economic Crisis)

63. From the literature, the following constitute the mitigating measures to reduce the negative impact the adoption of the ECOWAS CET might have had on the Nigerian economy through the real sector:

(i) Labour market reforms (flexible labour laws to enhance inter and intra industry mobility; training programme to provide qualified employees for export-oriented companies);

(ii) Technological support to private firms to improve ability to compete;

(iii) Improve domestic investment environment;

(iv) Establish effective competition policy;

(v) Establishment of social safety nets to compensate displaced workers;

(vi) Institute macroeconomic stability;

(vii) Embark on tax reform to increase collection efficiency and the tax base;

(viii) Encourage export sector development;

(ix) Make the ports more efficient to compete with foreign neighbouring ports e.g. Lagos ports versus Cotonou port; this will involve introducing trade facilitation measures and customs administration reforms;

(x) Elimination of exemptions and subsidies;

(xi) Address cost of doing business at the ports;

(xii) Put in place proper safeguard mechanisms and build capacity to implement it; and

(xiii) Identify sensitive products whose tariffs may not be liberalized further using globally accepted indicators.

64. Some of these measures are indeed being implemented at several levels but not as a consequence of the expected impact of tariff liberalization on the production systems in Nigeria but as a result of the need for reformation of the system under the general economic reform programme. For example, port and road concessioning have become part of the schemes to reduce transaction cost and facilitate trade while the Nigeria Investment Promotion Commission was restructured into a 'one-stop shop' to facilitate foreign direct investment entry and establishment into the country.

TOR 3: ***Examine the tariff structure of selected emerging economies that are achieving high rates of economic growth and diversification, especially in the real sector, with a view to adapting them to suit the Nigerian situation.***

65. Brazil, China, South Korea, and India are countries that are perceived to have started out on the path of industrialization as Nigeria at almost similar period while these countries have used import substitution strategy as Nigeria in the early stages of their development. These countries except Nigeria are currently considered newly industrializing countries with increased international economic power and influence particularly in the context of global trade policy by virtue of their sustained positive economic and trade performance. Malaysia and Indonesia share developing country characteristics with Nigeria while Angola, Mauritius, and South Africa are fellow African countries.

66. A proximate countries' analysis of how trade policy has been used to foster real sector growth thus should beam a searchlight on these newly industrializing developing countries that have continued to post consistent overall growth for over a decade. Table 10 indicate that these countries, in consonance with their outward orientation and export led growth policy, have liberalized their import regime. In particular, Brazil and China bound all their tariff lines while India bound over three quarters of its own. The average bound rates do not significantly differ from the average applied rates. Except in the case of India with average bound rate of 49%, the final average bound rate of Brazil and China are not significantly high. In the case of Nigeria, it bound 19.2 % of its total tariff lines at the HS eight-digit level at the WTO at the conclusion of the Uruguay Round. While all agricultural lines are bound, only 7 % of non-agricultural lines were bound. Final bound tariffs range from 40 percent on aluminum alloys and machinery, to 150 % on vegetable products, fats and oils, and prepared foods. The average bound tariff rate is 118.4 % (WTO, 2005).

67. Though India has some high tariffs at 60 % particularly on vegetables, its average tariff on agriculture is 38.2 %, representing a tripling of those of Brazil, China and Nigeria. In the case of manufacturing (industrial products), China has the lowest average applied MFN tariff of 8.8 % compared with 11.8 % in India and 11.6 % in Brazil. China's average tariff in textile and clothing is lowest at 11.5 % even when it produces

and exports over 50 % of global textiles. Interestingly, Nigeria's 2008 tariffs for all products are comparable to those of these three countries, but are slightly higher than that of China and lower that those of India.

68. However, Nigeria has the highest average tariff in textile and clothing compared to the three countries. This higher tariff rate is compounded by the import bans imposed in the sector. In addition, tariff rates of three main products of proximate countries in agricultural goods are compared with those of Nigeria. Clearly, despite the current tariffs, Nigeria has high tariffs for the three goods (Table 11). Ranking the protection among the various countries, in all products, Nigeria ranks third following India (15.1%) and South Korea (12.8%) while in agriculture tariff, South Korea ranks as the most protective country with simple average tariff of 47.8%, followed by India (38.2%), China (14.5%) and Nigeria (12.6%). Simple average manufacturing tariff in India is highest at 11.8% followed by Brazil and Nigeria (11.6%) and South Africa (11.4%). The simple average tariff of textiles and clothing is highest in South Africa (26.8%) with a close follow up by Brazil (25.1%) while Nigeria ranks third with 17.1%. Nigeria's pre-CET simple average tariffs in these four indicators are 28.6%; 41.4%; 28%; 42.7% respectively.

*TABLE 10: SIMPLE AVERAGE MFN TARIFFS COMPARED

	Simple Average MFN tariff							Import prohibitions
	Agri-culture	Manu-facturing	Textile & clothing	All Products	Range	Final Bound Average	Bound tariff lines (per cent of all tariff lines)	
razil (008)	10.1	11.6	25.1	11.5	0-35	30.2	100	used consumer goods
hina (007)	14.5	8.8	11.5	9.7		9.9	100	products of animal origin, opium, mineral products, rubber, chemicals, raw hides, waste of skins and leather, used clothes, ash of precious metals, base metals, second-hand precision equipment, games, and imports of used articles of HS sections 16 and 17 (machinery and transport equipment
ndia (2006-07)	38.2	11.8	12.3	15.1	0-60	48.6	75.2	livestock and livestock products, including domestic and wild birds, meat and meat products from avian species, and live pigs and pig meat products
ndonesia (2006)	11.4	9.2	10.9	9.5	0-90	40	93.2	Alcoholic beverages, lubricants, explosives, and certain dangerous chemical compounds, ozone depleting substances, and rough diamonds, among other items
Malaysia (2005)	3.2	8.7	12.6	8.1	0-25	16.2	63.5	Products include poultry and beef (which must come from facilities that have been approved as halal, or acceptable to Muslim consumers), eggs, rice, sugar, cement clinker, fireworks, magnetic tapes for video and audio recording, explosives, wood, safety helmets, diamonds, rice-milling machinery, colour copying machines, some telecommunications equipment, arms and ammunition, and saccharin
South Korea (2008)	47.8	6.5	9.7	12.8	0-100	17.1	90.8	To protect health, safety, security, public morality, the environment, and natural resources, and to prevent deceptive practices, in accordance with multilateral trade and other agreements. Prohibited products include: certain pornographic and other unacceptable material; goods that reveal confidential government information or intelligence activities; and counterfeit currency or financial instruments.
Angola (2005)	10	7.1	7.8	7.4	0-30	59.1	100	measures are stated to be in place for health, security, and safety purposes
Mauritius	8.5	6.8	16.9	6.6	0-277.5[a]	n.a.	15.7	apply to several categories of goods, mainly for health and safety reasons and include certain drugs, second-hand goods (other than motor vehicles), second-hand motorcycle/autocycle parts and accessories for resale and black tea
South Africa (2002)	11.5	11.4	26.8[c]	11.4	0-33	20.9	96	Uses contingency trade remedies and specific duties.
Nigeria (2008)	12.6	11.6	17.1[b]	11.6	0-35	118.4	19.2	See above analysis in Nigeria's case.

Source: Compiled from Trade Policy Reviews, World Trade Organisation, various years;

'a' tariff range between 0 and 277.5% in textile and clothing and Leather, rubber, footwear and travel goods; 'b' = 2005/06 CET rates; 'c' average bound rate; n.a = not available.

Table 11: Average of MFN Simple average tariff barriers in proximate countries (per cent)

Country	Fish& Crustacean	Cocoa & Preparations	Hides, skins & Leather
Brazil	9.3	15.1	7.5
China	11.7	11.0	10.0
Ghana	9.5	--	--
India	--	--	11.1
Indonesia	4.9	--	--
Malaysia	1.2	13.0	0.8
Mauritius	9.0	--	--
South Africa	--	--	3.7
Nigeria (2006 CET)[a]	12.76	12.5	11.7

Source: World Bank, 2006. 'a' = computed by author.
Note: (---) means that the country is not among the world's top-twenty importers of the respective products. Average across all tariff lines in the respective HS-chapter. Data for 2005 or latest year available.

TOR 4: Recommend Appropriate Changes in the Existing Tariff Structure and Import Protection Regime, as well as other Complementary and Compensatory Measures, for Enhancing Productivity in the Real Sector and Facilitating Rapid Economic Growth and Development.

69. Using tariffs to enhance productivity, generate economic growth and engender development involves a balancing of the trade policy objectives. While appropriate tariff policy should stimulate industrial production, through making available raw materials and machinery and parts at world prices, as well as protect domestic industry from damaging import competition in import sensitive sectors, the role of import policy in poverty alleviation by means of adequate provision of health goods, and products of basic needs such as food, housing, transportation, education and clothing cannot be treated as a trivial matter. A detailed analysis of the tariff structure as it relates to these issues is required in the future.

70. Meanwhile, the evidence in relation to Nigeria's tariff structure analyzed above generates the following six conclusions:

(i) Past frequent tariff changes and import prohibitions are not good for growth through their impact on uncertainty and unpredictability of the investment environment;

(ii) High tariffs and long list of import prohibitions foster large scale smuggling and corruption, high prices on consumer products as well as large Government revenue losses that are diverted into private pockets;

(iii) There are other constraining factors, such as high transaction costs, inadequate economic infrastructure and technological development, among others that affect real sector growth that high tariffs and import prohibitions should not aim to resolve as instruments and targets need to be appropriately matched;

(iv) Nigeria's current tariffs structure do not only compare with proximate countries' tariffs such as Brazil, India, and China, they have almost closely attained global best practice which is necessary to reap the benefit of globalization i.e. increased flows of trade, investment and capital and information and communication technology. However, this benefit remains to be seen in the future;

(v) The movement from the 2003 tariff levels to the adoption of the current CET-compliant structure was certainly drastic and involved substantial adjustment costs which were not compensated or mitigated. Tariffs were significantly reduced from a maximum of 150% to 50% in 2005 and 35% in 2008. In average terms, reduction of the simple average nominal tariff was as high as 58% (Table 1). Similarly, by the publication of the 2008-12 tariff book, most prohibited items were 'tariffied' at a low level of 35%, instead of their tariffs to reflect their hitherto prohibited nature by attracting more than 150% that was Nigeria's maximum tariff on some commodities. In addition, the ECOWAS CET is certainly not compatible with the waivers and exemptions that have characterized Nigeria's import policy regimes over time, implying that their use will be discontinued in full compliance with the CET regime. Prior to the eventual total phase-out of the waivers and exemptions, efforts should be made to streamline their application in the interim in such a way that company specific waivers and exemptions are eliminated first to provide level playing field for all producers. Such arrangement will require well-defined transparent criteria that are also published for intending beneficiaries; and

(vi) Though the movement to the CET regime was drastic and unmitigated, a reversal could be more problematic than if mitigating measures are

appropriately identified and used to prop up the CET structure. Some of the mitigating measures identified above are already being implemented e.g. port reforms and the reform of customs administration, but these reforms are not directly linked to the adjustment costs of the real sectors affected by the drastic reduction in tariffs, tariffication and potential discontinuation of waivers and exemptions. Efforts are therefore required to make such reforms dependent on the need to mitigate tariff liberalization shocks. In addition, changes might be necessary in the existing tariff structure and the import protection regime after an analysis of the ex-post impact has been conducted as suggested above. Such changes will have to be carried out in terms of a review of the CET at the level of the ECOWAS which may not be immediate given that negotiation has only just been concluded on the 5th band of 35%. Therefore, the import protection approaches of other customs union may be helpful to learn from and to institute a protection regime that will be WTO compliant.

Appropriate Changes in Existing Tariff Structure and Import Protection Regime

71. The 5th band of 35% was introduced to accommodate five types of products: products considered for safeguard measures; medicaments; health and tobacco products; environmental products; agricultural and food products (ECOWAP). Whether this 35 % is adequate to protect domestic producers though is an empirical question, evidence from the rate of protection in other African region and Asia where most of developing countries are located can be alluded to and used. The average rate of protection ranges between 15 and 30% except for some extreme cases in developed countries' agriculture, and tobacco products and cars in Southeast Asia[26]. In MERCOSUR tariffs are capped at 20% except for cars 35%; in the SACU, CEMAC and COMESA, highest tariffs are 30%. Therefore, for the purpose of protection, 35% is deemed adequate for Nigerian producers under normal protection circumstance.

72. However, in view of the type of operational costs disadvantage facing Nigerian producers not experienced by other countries' producers, this rate might seem too low. While efforts are being channeled toward solving operational costs problems, the 35%

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[26] Carana Corporation - Draft studies for the Finalisation of ECOWAS Common External Tariffs (CET), May 2008

rate on import sensitive products serve as a normal import protection measure and an incentive to continue to operate given that these products will not also be immediately liberalized under the EPA implementation. A serious limitation is that a higher tariff to counter import surges due to dumping and unfair trade practices and associated injury cannot be predetermined and imposed until that injury has been established.

73. In general, import protection measures to protect domestic industries and agriculture from injury induced by import surges and unfair trade practices that are consistent with WTO rules include:

(i) Tariff increases up to bound rates;

(ii) Antidumping and countervailing duties; and

(iii) Safeguard measures as well as tariff rate quotas to guard against import surges and low prices[27].

74. In the case of the first, tariffs can be raised up to the bound rates for the product for protection purpose without violating WTO rules. However, for Nigeria, this can be done for all agricultural goods and a few of industrial goods because only 7% are bound at the WTO. There is also the issue of the implication of the notification of the CET to the WTO which may make the applied CET rates become bound rates once they are notified to the WTO. In such a situation, this protection measure will no longer be available for use. However, it appears this can be remedied either by specifying common bound rates along with the CET applied rates when notification of the CET to the WTO is done by ECOWAS or by notifying that individual countries' existing bound rates are still operational. For example, the South African Customs Union, SACU, has 96% of its tariff lines at the eight digits bound at the WTO while some members have different bound rates.

75. Antidumping measures are imposed to counter established dumping cases, while countervailing duties are applied on imported goods which have been provided subsidies in the source countries that cause material injury or threat of material injury to domestic industry of the importing country. Antidumping and countervailing duties can

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[27] Ibid.

be used by Nigeria but need to be compliant with WTO Antidumping Agreement and the Agreement on Subsidy and Countervailing Duties, have to be investigated and applied in form of ad valorem duties and can be as high as 100%.

76. Safeguard measures on the other hand are applied when the importation of a product has increased to the extent of creating or threatening to create serious injury to domestic producers. Four Customs Unions reviewed, used a combination of these as protective measures (see Table 12 for a summary).

TABLE 12: PROTECTIVE MEASURES IN CUSTOMS UNIONS

Measures	SACU	EAC	MERCOSUR	EU-27
Establishment of Customs Union		2005	1991	2007
Protection from Dumping, Subsidies and Import surges	Yes. Formula duty based on reference prices	Yes. WTO compatible protection. Individual member to take necessary action by notification to EAC Council	Yes. WTO-compatible. Applied by each country but subject to final approval by the Group	Yes. Comply with WTO Agreement on safeguard, agreement on subsidies and countervailing measures, and antidumping agreement. Measures applied at the Community level
Protection for National Security and other reasons	Yes. Parallel GATT Articles XX and XXI provisions	Yes. For security laws, control of arms, protection of human life. Initiated by member countries	Not explicit	Yes. Based on international agreements, SPS and TBT regulations, Un Security Council restrictions
Protection of Infant Industry	Yes. Additional duties for eight years	No	Yes. Operated through a list of exception included in the Treaty	Not explicit
Bound and Applied Rates	Yes. Some countries e.g. Lesotho have different bound rates	Not explicit. Applied tariffs equal bound tariffs in some cases	Not available	Yes. Applied to both agriculture and non-agriculture tariff lines 100% of tariff line bound 98.4% of tariff lines have bound rates equal to applied rates
Other measures	None	Community tariffs.	None	combination of measures can be used

Source: Summarised from Carana Corporation - Draft studies for the Finalisation of ECOWAS Common External Tariffs (CET), May 2008

77. These three protective measures are already proposed under the CET by the ECOWAS Commission and are under consideration[28]. They will take the forms of ECOWAS Decreasing Protection Tax (DPT), Import Safeguard Tax (IST) and ECOWAS Countervailing Duty (ECVD) and are basically to protect import competing sectors and create special protection for key agricultural and food products as well as address

[28] Ibid.

distortion in world trade from export subsidies and domestic support. The first two of these instruments will be applied nationally subject to the approval of the ECOWAS CET Management Committee[29]. Its maximum starting rate will be additional 50% to existing CET tariff or a difference between the CET and national tariff of the affected product whichever is higher, and will be applied over 10 years. This is noted to be WTO-consistent because it will be notified to the WTO, will have an approved interim agreement of 10 years, is a transitional plan to adopting CET and is created under a customs union.

78. The IST is not considered consistent to WTO Agreement on Agriculture and Agreement on Safeguards because the affected products have not been designed in the CET with the symbol SSG with predetermined trigger volume or prices and ECOWAS does not yet have in place requirements to determine dumping of products in the region and associated material injury. Nonetheless, if used, the IST will affect rice, milk products, edible oils, sugar, wood products, fish and specific agro-industrial, and manufactured products and will be automatically triggered when the price or volume threshold are breached. While additional IST duty can be as high as 100% of the percentage reduction of price of imports or 50% of percentage increase in volume, it is designed to last for an initial one year with possibility of annual review.

79. The CET Management Committee will apply the ECVD if it established that subsidies and domestic support cause injury or threaten to cause injury to ECOWAS producers in agriculture, livestock, fishing or food processing industry. ECOWAS has also not instituted WTO procedures for imposing countervailing duties hence its ECVD is considered inconsistent with WTO Agreement on Subsidies and Countervailing Measures: subsidies can only be determined on country or customs union basis and not as OECD average as proposed by ECOWAS; distinction must be made between actionable and prohibited subsidies which must be established and the injury they cause as well as the link between the subsidized imports and the injury proved; countervailing duties must reflect actual benefit by exporters; all procedures for imposing countervailing duties must be followed; and injury must be caused by

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[29] Community-wide sanctioned protective measures will prevent circumvention of the measure through transshipment and smuggling; comply with GATT article XXIVwith respect to liberalization of substantially all trade in the customs union; and maximize human capacity utilization at the ECOWAS Commission as a single administration agency.

subsidized imports. Nigeria will need to lead ECOWAS in following, influencing and implementing the Special Safeguard Mechanism under discussion in the Doha Round to make this protective measures benefit Nigerian producers.

80. Tariff rate quotas or moving tariffs toward the bound rates have been suggested as easier to implement than countervailing duties as long as bound rates are not exceeded. In the case of tariffs, one way could be to calculate the tariff equivalent of the remedies proposed under IST or ECVD and use as additional tariffs to reach bound rates. However, there is the risk that the actual injury caused may require a higher tariff that cannot be predetermined. The tariff rate quota when established for particular sensitive products will ensure that imports, after a volume or price trigger has been breached, are subject to higher tariffs up to the bound rates. Its implementation requires transparency in import licensing, just determination of the volume or piece trigger, as well as prompt immediate data to be able to swiftly determine when the triggers have been breached. Hence, a special purpose data collection instrument for sensitive products should be established within the National Bureau of Statistics which have a real time direct link to Customs to obtain data on minute by minute basis, data which can be collated daily or weekly for onward transmission to a tariff review body. The body will use these data when approached by an injured industry or sector, prepare its case and then invoke the protective measure and notify ECOWAS. This body could be a fully-fledged Commission that will handle all of the procedures enumerated[30].

81. For successful implementation, it is necessary to build capacity to determine trigger volumes and prices, to establish real time data upload, download and transmission between agencies, and to collate, analyze and interpret volume and price trends. It is also necessary to build capacity to identify sensitive products that will be subject to these additional protective measures.

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[30] According to the submission by the Federal Ministry of Commerce and Industry, a Nigeria Trade and Competition Commission (NTCC) was previously recommended by it for establishment to be charged with the responsibilities concerning anti-dumping ; subsides and countervailing measures ;safeguards ; anti-trust and competitions ; consumer protection ; and weights and measures administration. This proposal already approved by the Federal Government and drafted a Nigerian Trade and Competition Commission (NTCC) Bill 2008 (SB 80) has been jettisoned because of multiple submissions by various bodies. The FMCI still recommends that the Bill be considered along with the (a) Dumped and Subsidised Goods Act ; (b) Anti-trust and Competition Act ; (c) Safeguards Act ; (d) Consumer Protection (Special Provisions, etc) Act ; and (e) Weights and Measures Act so as not to create the NTCC in a vacuum. It further proposes that another Bill before the House of Representatives seeking to establish the Federal Competition Commission (FCC) should be harmonized and fused by the Senate Joint Committee to save time and costs and reduce multiplicity of regulatory institutions in the trade sector.

82. In view of the manner of evolution of the ECOWAS Common External Tariffs, that involved consultations and intra-ECOWAS negotiations and agreement, it is recommended that:

(i) The current tariff structure be retained. However, the CET should be applied in combination with standard WTO-compliant protective measures that will allow relevant government agency protect productive sectors as the case arises;

(ii) The ability to use these additional instruments depends on the existence of well-staffed professionally competent agency of Government that can deal with issues relating to unfair trade practices, dumping, import surges and subsidized imports. Nigeria does not presently have such an agency. Therefore, in line with WTO rules and the practice in some countries, it is recommended that government should establish a Nigeria Trade and Competition Commission to be able to promptly address the issues which include:

- Determination of the volume or price triggers.
- Prompt data gathering through real time direct link to Customs to obtain data on minute by minute basis to swiftly determine when triggers have been breached.
- Speedy transmission of data to relevant bodies for reports.
- Investigation of injury cases by industry and preparation and invocation of protective measure and notify ECOWAS.

(iii) Nigeria should use and strengthen existing machinery to follow with keen interest, with a view to influencing, the formulation in process of special protective measures of the ECOWAS Commission. The machinery should also follow the Special Safeguard Mechanism under discussion in the Doha Round to make this protective measures benefit Nigerian producers;

(iv) Because the CET does not preclude the use of special levies which are also in the process of harmonization at the ECOWAS level, Nigeria should as well effectively participate in this process to ensure that existing important levies in Nigeria are retained;

(v) The capacity of the Standards Organisation of Nigeria (SON) and the National Foods and Drugs Administration Agency (NAFDAC) should be strengthened to become increasingly relevant to Nigeria's trade policy; and

(vi) In view of the dearth of studies noted above, there is need for more detailed studies on the impact of tariff on the economy. Therefore, government needs to conduct regular detailed studies to evaluate these impacts.

Appropriate Changes in Complementary and Compensatory Measures

83. Economies which embark on substantial liberalization tend to do so over a fairly long period to allow a phased-in liberalization such that producers imbibe the implications of the envisaged liberalization in such a way that it does not disrupt the production structure of the economy[31]. This was not the case in Nigeria, which after bouts of liberalization and reversals of same decided to abruptly adopt the ECOWAS CET in 2005. In the absence of a well-structured phase-in plan, it is necessary to provide adjustment support for affected enterprises. Hence, there is a need to design and implement adjustment support for Nigerian farmers and firms to withstand the liberalization that has been done through the adoption of the ECOWAS CET since 2005. This support can never be too late, particularly under worsening infrastructural deficiencies.

84. The forms of the compensatory and support mechanism should constitute an important part of the design. First, there is a need to review the fiscal, trade and financial incentive system with a view to enhancing their effectiveness and coverage, as well as assess the needs for them. Such a needs assessment will reveal the usefulness of existing incentives, their performance and relevance to the 20:2020 Vision. Secondly, in view of the fact that adjustment support for firms that are injured by increased competition due to CET adoption is required, such a review will probably determine

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[31] An example is the phase-out of the Multi-fibre Arrangement between the Quad (textiles importing) countries and textile exporting countries which lasted for 10 years with most of the liberalization back-loaded.

which incentive is best for a particular sector in the circumstance, in such a way that 'double dipping'[32] will be discouraged.

85. Currently, Nigeria has incentives in the area of industrial and export development. A similar incentive structure will be required for import-competing firms whose products suffer proven material injury or are under threats of material injury from import surges. In effect, because affected companies will probably not qualify for the many incentives based on performance criteria of output growth, export performance, capital investment growth, employment growth, local content and local value added, a specially designed support system which ensures that producers will be able to update machinery, maintain workers, and regain competitiveness will be most appropriate.

86. The burden of proof of material injury, specifying the magnitude in monetary terms, still lies with the producers and should then be thoroughly investigated by the Tariff Review Board/Committee or the NTCC. In addition to this, established mechanism for manpower training should be strengthened to deal with trade policy related unemployment in the area of retraining and retooling workers to migrate to other areas of the economy such as the export sector while existing social safety nets will need to be expanded to compensate displaced workers due to import liberalization. Deliberate policy of export development should be established to also help producers to shift production where possible to the export sector to take advantage of improved market access created by virtue of such trade negotiations and agreements as the Doha round and the economic partnership agreement.

87. In view of the challenges of the CET, it is recommended that:

(i) Government should provide support to domestic producers affected by the drastic reduction in tariffs;

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[32] A situation where one firm by virtue of the design of the incentive system has access to more than one incentive schemes for the same or similar qualification. E.g. beneficiaries of EEG if not prohibited can also enjoy other industrial incentives such as Manufacturers Export In-Bond Scheme (MIBS).

(ii) In the long term, existing incentives need to be restructured to take cognizant of injured firms due to tariff or import liberalization. This is because existing incentives are designed around company performance criteria which injured firms will not meet. Incentives to combat problems created by import liberalization can take the form of:

- Increased asset depreciation allowance to 10%.
- Tax relief for research and development.
- Re-investment allowance.
- Minimum local raw material utilisation.
- Reduced Companies Income Tax to 10%.

(iii) The burden of proof to benefit from these incentives lies on the beneficiary, therefore, the incentives should be stopped immediately there is evidence of the beneficiary regaining its production base and market;

(iv) There are some Government actions which have a semblance of mitigation measures but are not linked to tariff liberalization shocks, the Government should therefore:

- Strengthen established mechanism for manpower training to deal with trade policy related unemployment. In effect, the National Directorate of Employment should design ways to retrain and retool workers to migrate to other areas export sector (e.g. Garments production under the African Growth and Opportunities Act (AGOA).
- Expand existing social safety nets to compensate displaced workers due to import liberalization (e.g. National Poverty Eradication Programme on (NAPEP).

(v) Strengthen policy of export development (through the Nigeria Export Promotion Commission (NEPC)) to help producers to shift production where possible to the export sector to take advantage of improved market access created by virtue of such trade negotiations and agreements as the Doha round and the economic partnership agreement.

COMMITTEE'S FINDINGS ON TARIFF STRUCTURE

88. Government's objectives of imposing tariffs are to progressively liberalise the import regime with a view to promoting efficiency and international competitiveness of domestic industries and do away with undesirable protection, reduce the uncertainty and unpredictability of the trade policy regime, and harmonize trade practices with those of other ECOWAS countries. However, the instruments and the commitment to implementation of trade policy have not been so consistent with Government's articulated objectives.

89. The current structure of Nigeria's tariffs is in compliance with the ECOWAS CET with 5 tariff bands that range between 0% and 35%. These bands are in category 0 (0 per cent) for industrial machinery/equipment and medicaments such as malaria drugs, polio vaccines, HIV Test Kits, Treated Mosquito nets, etc; category 1 (5%) for industrial raw materials; category 2 (10%) for semi-finished manufactured goods; category 3 (20%) for finished goods; and category 4 (35%) for manufactured goods of strategic importance to the nation.

90. As a result of the adoption of the CET, the protection of domestic producers of all products on the average reduced by more than 50%. In the case of agriculture, the protection was reduced by almost 70%. Many consumer products such as textiles and poultry products have been under import prohibition. If this is considered, the reduction in the protection of domestic producers becomes very substantial. The reduction of protection to domestic producers was also sudden as normal time required for them to absorb the fact of intense competition from foreign producers was not observed. Despite the size and suddenness of the reduction in the protection to domestic industrialists and farmers, Government did not directly provide measures that would permit domestic producers to absorb the sudden shock that emanated from adopting low tariff rates and cancelling import prohibition.

91. Inputs from some of the stakeholders indicated that in adopting CET, there is need for consistency and if import prohibition were to be removed, those products affected should attract the highest tariff of 35%. The highest tariff in the Francophone ECOWAS was 20% before the agreement to adopt the 5th band of 35% suggested by Nigeria. The adoption of the 5th band of 35% by the Francophone ECOWAS, after intense negotiations, made them violate their existing WTO rules. This fact makes it difficult to

negotiate the 5th band to a level higher than 35% and led to Nigeria's reduction of the 50% maximum tariff adopted in 2005.

92. Though the CET precludes the use of waivers and exemptions, just as it does import prohibitions, these instruments will no longer be available for use to favour particular industries over others. The existing studies showed that the impact of the CET structure will be on the tariff structure, Government fiscal revenue, and Nigeria's imports as well as on Nigeria's process of industrialization. The studies suggest that the current CET structure can help ameliorate the problems of cumbersome customs administration and may also reduce smuggling. It also shows that Government may lose significant revenue, estimated between N100 billion and N150 billion annually as a result of the current structure between 6.9% and 8.8% of total Government revenue per annum, if other complementary measures to reduce this impact are not implemented.

93. Accordingly, Government may lose less revenue by collecting import duties more effectively, and eliminating exemptions. Total loss of Government revenue could reduce to about N50 billion annually. Nigeria is likely to increase imports by between 3 % and 6% representing between N34.4billion and N68.8billion of 2002 Imports at current prices. Available economy-wide study suggests that the negative impact of the CET on Nigeria may be small due to higher import of agricultural goods by 7% and decline in the import of manufactured goods by 4% in both the short and long run.

94. The impact of the CET as a result of replacing import prohibition with the maximum tariff of 35% is likely to increase imports. However, increased imports would affect mainly domestically produced goods such as medicaments; African print fabrics, Carpets, Lace Fabrics, Towels; Vegetable Oils and Fats; Maize, Millet, Sorghum; Maize Flour; Pork, Beef, Mutton, Lamb and Goat Meat; Frozen Poultry; Furniture; Foot Wears and Bags. This increased would nonetheless bring additional import duty to the Government. There is a dearth of very recent studies on Nigeria's tariffs and fiscal incentives as well as on the impacts on the economy. The applicability of the results contained in the studies needs to be updated with current studies.

95. The type of mitigating measures that have been applied when embarking on drastic reduction of protection to domestic producers include phasing in of the tariff liberalization for about 10 years, and embarking on sweeping social and economic reforms. These reforms involve the following:

(i) Labour market reforms that allow flexible labour laws to enhance movement of workers within and between sectors; and strengthening of training programme to provide qualified employees for export-oriented companies;

(ii) Technological support to private firms to improve ability to compete through incentives that encourage adoption of new technologies; and

(iii) Improvement of domestic investment environment;

- establishment of effective competition policy, and
- establishment of social safety nets to compensate displaced workers. Most of the economic reforms embarked upon have not been targeted at addressing the challenges consequent upon adopting the CET on domestic producers and workers.

96. Nigeria's current tariffs structure on the average compares with proximate countries' tariffs such as Brazil, India, China, Malaysia, Indonesia, South Korea, and South Africa particularly in the manufacturing sector and considering all products together. However, Nigeria has the lowest tariff protection in agriculture when compared to South Korea, India, and China. It also has the lowest protection in textiles and clothing when compared to South Africa and Brazil. All these countries use strict international standards to combat unbridled imports, including import prohibitions, particularly as they relate to the protection of health, safety, security, public morality, and the environment.

97. The global average rate of protection for domestic producers is between 15% and 30%, though there are some exceptionally high tariffs on products considered to be very strategic in some countries. Customs Unions such as the European Union, Southern Africa Customs Union, among others, use additional WTO-compliant protective measures to protect their domestic producers even when they have such low tariff rates as the ECOWAS CET. Such measures address sudden influx of imports, dumping and export subsidies on the imported products. These measures include safeguard measures, and anti dumping and countervailing duties to immediately stop influx of imports due to import liberalisation. These countries possess the institutional arrangement to implement safeguards, and anti-dumping and countervailing duties to stop import surges due to tariff liberalisation.

COMMITTEE'S RECOMMENDATIONS ON TARIFFS:

Maintain CET with WTO-Compliant Protection

98. Considering the manner of evolution of the ECOWAS Common External Tariffs, that involved consultations and intra-ECOWAS negotiations and agreement, it is recommended that the current tariff structure be retained. However, the CET should be applied in combination with standard WTO-compliant protective measures that will allow relevant Government agency protect productive sectors as the case arises. The ability to use these additional instruments depends on the existence of well-staffed professionally competent agency of Government that can deal with issues relating to unfair trade practices, dumping, import surges and subsidized imports.

99. Nigeria does not presently have such an agency, therefore, in line with WTO rules and the practices in some countries, it is recommended that Government should establish a Nigeria Trade and Competition Commission to be able to promptly address the following issues:

(i) Determination of the volume or price triggers;

(ii) Prompt data gathering through real time direct link to Customs to Obtain data on minute by minute basis to swiftly determine when triggers have been breached;

(iii) Speedy transmission of data to relevant bodies for reports; and

(iv) Investigation of injury cases by industry and the preparation and invocation of protective measures and notify ECOWAS.

Increase Effective Participation in WTO and ECOWAS Negotiations

100. Nigeria should use and strengthen existing machinery to follow with keen interest, with a view to influencing, the formulation process of special protective measures of the ECOWAS Commission. The machinery should also follow the Special Safeguard Mechanism under discussion in the Doha Round to make this protective measures benefit Nigerian producers. As the CET does not preclude the use of special levies which are also in the process of harmonization at the ECOWAS level, Nigeria should as well effectively participate in this process to ensure that existing important levies in Nigeria are retained.

Adopt WTO-Complaint Non-Tariff Barriers in Trade Policy

101. There is need to strengthen the capacity of the Standards Organization of Nigeria (SON) and the National Foods and Drugs Administration Agency (NAFDAC) to increase their relevance to Nigeria's trade policy.

Conduct Regular Impact Studies

102. In view of the dearth of studies to properly evaluate the impact of tariffs and fiscal incentives, there is need for more detailed studies on the impact of tariff on the economy. Therefore, government needs to conduct regular detailed studies to evaluate these impacts.

Provide Short and Long-term Support Framework

103. Considering the challenges of the CET, it is recommended that Government should provide support to domestic producers affected by the drastic reduction in tariffs. In the long term, existing incentives need to be restructured to take cognizance of injured firms due to tariff or import liberalization. This is because existing incentives are designed around company performance criteria which injured firms will not meet. Incentives to combat problems created by import liberalization can take the following form:

(i) Increased asset depreciation allowance to 10%;

(ii) Tax relief for research and development;

(iii) Re-investment allowance;

(iv) Minimum local raw material utilization; and

(v) Reduced Companies Income Tax to 10%.

104. The burden of proof to benefit from these incentives lies on the beneficiary. The incentives should be stopped immediately, if there is evidence of the beneficiary regaining its production base and market.

Strengthen Employment, Export, and Safety Nets Agencies

105. There are some government actions which have a semblance of mitigation measures but are not linked to tariff liberalization shocks. Therefore, the government should strengthen established mechanism for manpower training to deal with trade policy related unemployment. In effect, the National Directorate of Employment should design ways to retrain and retool workers to migrate to other areas export sector (e.g. Garments production under the African Growth and Opportunities Act (AGOA)). In

addition, Government should expand existing social safety nets to compensate displaced workers due to import liberalization (e.g. National on Poverty Eradication Programme (NAPEP).

106. Government should also strengthen policy on export development through the Nigeria Export Promotion Council (NEPC)) to help producers to shift production where possible to the export sector to take advantage of improved market access created by virtue of such trade negotiations and agreements such as the Doha Round and the Economic Partnership Agreement.

Institute an Appropriate Fiscal Incentives Regime

107. Government should correctly align the list of incentives to the objectives of the need to correct for externalities and mitigate the effects of other policy-induced distortions. All incentives should be potentially made available to all the industries and case-by-case granting of incentives should be discontinued. Government should rationalize the number of incentive granting bodies and should in case more than one incentive granting body emerged in the process of harmonization. The Committee also recommended that an effective coordination mechanism should be instituted to ensure that efforts are neither duplicated nor permit double-dipping. The processes and procedures for granting fiscal incentives need to be clearly stated, simplified, readily available and accessible to all stakeholders.

Monitoring and Evaluation Framework for Fiscal Incentives

108. Monitoring and Evaluation of fiscal incentives granted should be on regular basis with a view to ascertain the costs and benefits of incentives, noting that the costs include administrative costs and forgone Government revenue. It should also ascertain the achievement of targeted goals and check for potential abuses.

NON-TARIFF FISCAL INCENTIVES IN NIGERIA

INTRODUCTION

109. Some of the recent developments are bound to have significant impact on domestic economic management. Two of these developments have implications for domestic economic management. In the first instance, the recent triple-f crises (food-fuel-financial crises) with their differentiated impact on countries have implication for external sources of public finance. The impact of the fuel crisis on net-oil exporter is quite different from its impact on net-oil importer. Similarly while the food crisis benefited net-food exporter it created a challenge for net-food importer. Although the impact of financial crisis is not that clear cut most countries are negatively affected. The impact of these crises on the external sources public finance then implies efficient management of domestic resources.

110. Secondly, the increasing rate of Nigeria's integration into the world economy also has implications for fiscal policy. Nigeria is currently engaged in three levels of trade negotiations; the regional level in the context of the adoption Economic Community of West African States (ECOWAS) common external tariff (CET) towards creating a customs union in West Africa, the negotiations of the Economic Partnership Agreement (EPA) between the European Union (EU) and ECOWAS, and the negotiations of the Doha Development Agreement (DDA) in the World Trade Organization (WTO). The impact of these negotiations is on tariff revenue may require development new sources of revenue and efficient management of existing ones. Thus, domestic policies that could be legally applied to promote economic growth without contravening provisions of the various agreements must be efficiently applied. These and other developments while justifying the need for a critical evaluation of domestic resource mobilization and fiscal incentives, a periodic review of these incentives should be an integral component of evaluation with a view to ensuring their effectiveness.

111. This section of the study on "the Review of Nigeria's Tariff Regimes and Fiscal Incentives" focuses on the non-tariff fiscal incentives with a view to:

(i) Review the existing structure of non-tariff fiscal incentives in Nigeria, paying particular attention to their evolution, objectives and modalities;

(ii) Review existing studies on the non-tariff fiscal incentives with particular focus on their impact and limitations;

(iii) Examine the non-tariff fiscal incentives of selected rapid-growth and diversified emerging economies with a view to adapting them to suit the Nigerian situation; and

(iv) Recommend appropriate changes in Nigeria's non-tariff fiscal incentives with the objective of enhancing productivity in the real sector, promoting greater diversification, and facilitating rapid economic growth and development.

112. Consequently, the remaining sections of this Report are as follows: Section II presents conceptual issues in the analysis of fiscal incentives. Section II reviews the structure of fiscal incentives in Nigeria drawing largely from existing studies. Section III focuses on lessons of experience and Section IV concludes the Report with recommendations on how to make non-tariff fiscal incentives more effective in enhancing productivity, promoting greater diversification and facilitating rapid economic growth and development.

Conceptual Issues in the Analysis of Fiscal Incentives

113. An incentive is any factor and/or action that enables or motivates a particular course of action, or influence the preference order of an economic agent. The incentive counts as a reason for preferring a particular choice over and above competing alternatives. Fiscal incentive is a reduction in either the tax *rate*, the tax *base* or the tax *liability*, which is granted to induce the targeted beneficiary to take a specific action or behave in a particular way[33]. The fiscal incentive reduces the tax rate if, for example, it is given in the form of a tax holiday (reduces the tax rate to zero during the "holiday" period); it is a reduction in the tax base if it takes the form of accelerated depreciation or

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[33] A broader definition of fiscal incentives would include all actions that confer special advantage on a selected group of stakeholders with a view to elicit a particular behaviour. Thus apart from tax, other elements may include subsidies and other forms of differential treatment.

immediate write-off of investment expenditure; and it reduces tax liability if it takes the form of a tax credit.

114. The beneficiary of a fiscal incentive is a (potential or actual) tax-payer who is selected on the basis of certain "qualifications" or characteristics such as, for instance:

(i) Type of Organization;

(ii) Origin (national or foreign);

(iii) Age (newcomer or established);

(iv) Type of economic activity engaged in (manufacturing, agriculture, export, etc).

115. The primary justification for granting fiscal incentives is to compensate for externalities. In particular, if an activity is associated with a positive externality that cannot be internalized by the private economic agent involved, Government could intervene by granting a subsidy (or fiscal incentive) to encourage the activity. A secondary justification for granting fiscal incentives is to mitigate the effects of other policy-induced distortions. For example, exports using imported raw materials, which are subject to import tariffs, frequently receive duty drawbacks, reduction of and exemptions from import tariffs to reduce the cost disadvantage imposed on them by the levy of the tariffs. In the context of both types of justification, a fiscal incentive can improve overall welfare when given to an activity whose private cost exceeds its social cost or when the private benefit from the activity falls short of the social benefit.

116. A fiscal incentive is effective when it induces the desired behaviour. An ineffective fiscal incentive does not change economic behaviour; but it leads to the appropriation of windfall profits or economic rents by the beneficiaries. A fiscal incentive scheme should aim at removing negative externalities and inducing positive ones. The empirical literature has been inconclusive on the effectiveness of tax incentive schemes. The following factors tend to render fiscal incentives ineffective:

(i) Too many objectives pursued with limited resources;

(ii) Excessive selectivity in the incentive granting process;

(iii) Lack of transparency and predictability in the granting of the incentives; and

(iv) Too much political influence of vested interests in the design and implementation of fiscal incentive schemes.

117. In many developing countries, fiscal incentives are commonly granted at the discretion of the administrative branch of the government. This eases the transfer of resources since it can by-pass the political decision-making process involved in normal tax legislation and is not controlled by the usual budgetary mechanisms.
Optimal design and selection of fiscal incentives must be guided by efficiency consideration, that is, ability of the fiscal incentives to deliver on the targeted goal with minimal distortions and at least cost to the treasury. Efficiency of fiscal incentives can be examined at two levels; first, the introduction of fiscal incentives is a second-best approach as they are meant to address externalities that are inherent in the investment environment. These incentives cannot and should not be viewed as substitute to fundamental determinants of investment. They are no substitutes for political stability; adequate, relevant and reliable infrastructure, affordable and accessible credit facilities, efficient market, skilled labour force etc. Indeed fiscal incentives tend to penalize efficient firms! At the second level, relative efficiency of different fiscal incentives implies careful design and implementation.

118. The ability of incentives to induce the desired behaviour at the least cost is the main consideration in the analysis of efficiency at this level. The analysis of the costs and benefits of fiscal incentive is at the centre of an evaluation of fiscal incentives and basically there are two main approaches to the evaluation of fiscal incentives: Micro perspective focus on the assessment of the significance of incentive programme in the investment decisions of beneficiaries. Macro perspective, on the other hand, emphasizes the assessment of the overall cost and benefit of the programme to the Government and to the economy. The former is of primary interest in the analysis of the cost and benefits to the economy and the latter is concerned with beneficiaries' interest. However, a comprehensive view of the issue is required for the effective design, evaluation and monitoring of fiscal incentives.

119. Unlike tariff regime, the legislation on non-tariff fiscal incentives does not preclude other tiers of Government (state and local governments) from floating different

non-tariff fiscal incentives with a few to attracting location of industry than would otherwise have been located in absence of State or Local Government non-tariff fiscal incentives. Apart from inter-governmental activities in non-tariff fiscal incentives, different types of fiscal incentives, exist and thus are governed by different legislations even at the central Government. Put differently, there are as many legislation as the number of non-tariff fiscal incentives and effect different Government agencies are responsible for administering, management and evaluation of the different policies.

120. Also of importance is the possible trade-offs among different types of fiscal incentives. In particular, an analysis of trade off between tariff and non-tariff fiscal incentives may throw more light on the appropriate balance between these two groups of fiscal incentives. A significant change in, say, tariff regime such as has been witnessed in the process of harmonization of tariffs in West Africa and the introduction of common external tariffs, may necessitate a significant review of the non-tariff fiscal incentives at least for firms to enjoy comparable level of protection prior to the change in tariff regime.

121. Since various incentives can be instituted, different classifications are possible. A broad classification is presented in Box 1. This is based on the level of production targeted such as inputs, outputs and externalities. Thus, input-related, output-related and externality-related incentives can be identified and analyzed. It is also possible to distinguish incentives that are of general applicability from sector-specific incentives. It also demarcates fiscal incentives applicable to the domestic firms from those that aimed at promoting foreign investment. Similarly, distinction between incentives that are meant to promote capital accumulation as different from those that are designed to promote employment is also possible.

Typology of Fiscal Incentives

A. **Input-Related Incentives**

1. Intermediate Input-Related
   - tariff and tax exemptions/rebates on imported inputs
   - import credits
   - reduced prices of public utility inputs
2. Primary Input-Related
   - accelerated depreciation
   - reduced interest rates
   - investment loans (preferential access)
   - wage and/or labour training subsidy

B. **Output-Related Incentives**

1. Direct Output-Related
   - production loans (preferential access/interest rate subsidy)
   - domestic direct/indirect tax exemptions/rebates
   - import entitlement/licenses
   - export subsidies (credits, subsidized insurance etc)
2. Indirect Output-Related
   - infrastructure provision
   - overseas marketing support
   - subsidies for R&D expenses

C. **Externality-Related Incentives**

- product quality inspection
- monopoly rights granted in new product markets.

CONSIDERATION OF THE TERM OF REFERENCE: FISCAL INCENTIVES

ToR1: Review the Existing Structure of Fiscal Incentives in Nigeria, paying particular attention to its Evolution, Objectives and Modalities.

122. There appears to be a strong association between fiscal incentives and industrial development policy regimes. When import substitution industrialization strategy (ISI) held sway, non-tariff fiscal incentives were limited to a few general incentives mainly directed at inputs. However, the introduction of Structural Adjustment Programme (SAP) in 1986 and later the review/dismantle of indigenization programme led to the introduction of an array of non-tariff fiscal incentives. The establishment of Nigerian Investment Promotion Commission (NIPC) and promulgation of the Company and Allied Matters Decree (Number 1 of 1990) which replaced Company Act of 1968 set the tone for the new regime. Various fiscal incentives are an integrated component of the reform.

123. Fiscal incentives in Nigeria are numerous, and cover almost all the sectors of the economy. Although evidence points to their existence even before the country's

independence in 1960, a watershed in the history of fiscal incentives in Nigeria both in terms of number and dimension was recorded in 1976. Fiscal incentives were mainly of general nature prior to 1976 when explicit introduction of export incentives was witnessed. Another landmark was also recorded in 1986.

124. In 1976, when Nigerian Export Promotion Council (NEPC) was established, various export incentives were introduced and old ones were modified and were made more generous for export-oriented firms. The introduction of the Structural Adjustment Programme (SAP) in 1986 was also accompanied with various fiscal incentives. Apart from incentives directed at promoting export, there were numerous incentives directed at promoting different areas of the Nigerian economy. At a glance the list of incentives in Nigeria as presented by NIPC include the following and Annex 1 provides a brief outline of some of these instruments. The list of investment non-tariff fiscal incentives in Nigeria as presented by NIPC by categories is as follows:

General Incentives:

(i) Companies Income Tax;
(ii) Pioneer Status;
(iii) Tax Relief for Research and Development;
(v) Capital Allowances;
(vi) In-plant Training;
(vii) Investment in Infrastructure;
(viii) Investment in Economically Disadvantage Areas;
(ix) Labour Intensive Mode of Production;
(x) Local Value-added;
(xi) Re-investment Allowance; and
(xii) Minimum local raw material utilization.

Sectoral Incentives:

(i) Industry;
(ii) Agriculture;
(iii) Solid Minerals;
(iv) Petroleum;
(v) Gas Industry;

- Gas production phase

- ❖ Gas transmission and distribution
- ❖ LNG project
- ❖ Gas exploitation (upstream operation)
- ❖ Gas utilization (downstream operation)

(vi) Telecommunications;

(vii) Energy (electricity);

(viii) Tourism;

(ix) Transport; and

(x) Biofuel industry.

Export Incentives:

(i) Manufacturing-in-bond;

(ii) Duty Drawback Scheme;

(iii) Duty Drawback Facilities;

(iv) Export Expansion Grant (EEG) Scheme;

(v) Export Development Fund Scheme;

(vi) Oil and Gas Free Zone; and

(vii) Nigeria Export Processing Zones.

Other Incentives, Benefits and Guarantees:

(i) Incentives for Special Investment;

(ii) Double Taxation Agreements;

(iii) Investment Promotion and Protection Agreement (IPPA);

(iv) Liberalization of Ownership Structure;

(v) Repatriation of Profit; and

(vi) Guarantees against Expropriation.

125. From the list of incentives two observations are appropriate:

(i) There are many incentives in Nigeria cutting across most sectors of the Nigerian economy: agriculture including biofuel; Manufacturing, Mining (petroleum, solid minerals, Gas); Services (telecommunications, tourism, transport, electricity); and

(ii) These incentives are meant to address various issues such as encouraging firms to: invest in research and development; train staff;

invest in infrastructure; invest in economically disadvantage areas; increase local value addition; and increase the use of local raw materials.

126. Based on these observations, it would be desirable to harmonize different types of incentives and efforts should be geared towards making them effective. As noted by the Presidential Committee on the Review of Incentives, Waivers and Concessions some of these incentives are ineffective and/or not implemented, thus reinforcing the need for rationalization.

127. In addition to specific fiscal incentives, some of the identified general incentives are contained in the package of sectoral and export incentives categories. For example, Ogunkola and Bankole (2005) identified about 20 incentives in the export incentives package (see Appendix Table 1). In specific term, most of the packages listed above contained elements of general incentives such as pioneer industries' relief, tax allowance on research and development, company income tax relief, capital allowances, tax free dividends. The following paragraphs outline some of the incentives in Nigeria starting with a few general incentives and then proceed to analyze other categories. In the first categories are the elements that are general in nature and as such have featured in more than one incentive package. The export incentives are then analyzed.

Pioneer Industries' Relief

128. Pioneer Industries' Relief is a common element to these packages. The aim of this type of incentive is to encourage the pioneer industry to make a reasonable level of profit within its formative years. The profit so made is expected to be ploughed back into the business. It is a **tax holiday** granted to qualified or eligible industries anywhere in Nigeria.

129. Currently, it is a seven-year tax holiday in respect of industries located in an economically disadvantaged local government area of Nigeria. To qualify, a joint venture company or a wholly foreign-owned company must have incurred a capital expenditure of **not less than N5 million** whilst that of a qualified indigenous company should **not be less than N150,000**. In addition, an application in respect of Pioneer Status must be submitted **within one year** the applicant company starts commercial production otherwise the application will be time-barred.

130. According to Phillips (1967), Nigeria's pioneer companies' relief was first introduced by the Aid to Pioneer Ordinance in 1952. Under this scheme a pioneer industry and a firm can obtain a pioneer certificate which entitles it to (a) tax holiday of 3 to 5 years. The number of years for the holiday increases with the level of capital invested. Losses incurred during the period of the holiday can be offset against profit earned after the holiday.

131. In the late 1960s a number of firms were benefiting from this incentive covering a wide range of activity including:

(i) Processing of oil seeds;
(ii) Cement manufacture;
(iii) Production of biscuits;
(iv) Textiles;
(vi) Footwear;
(vii) Travel goods;
(viii) Paints;
(ix) Sugar;
(x) Rubber goods; and
(xi) Tin smelting etc. (see Asiodu, 1967).

132. The scheme has been criticized on many grounds including lack of greater selectivity in granting the pioneer certificate and opaque and arbitrariness inherent in the process of granting the certificate. Thus, it has been suggested that only companies with growth-inducing possibilities or of national importance should be granted the certificate. It was even argued that, for example, "cement industry which is very important and derives the bulk of its raw materials from local sources has become mature enough not to require pioneer certificate to simulate further investment" Asiodu (1967, p. 163). Similarly it has been suggested that any appearance of arbitrariness in the granting of pioneer certificate should be removed. Some suggested criteria for granting the license in a transparent manner are the inclusion of adequate capital structure, sustainability and adequacy of plants, and realistic estimates of market possibilities.

133. It is interesting that this type of incentive, arguably the oldest, has over the years been criticized and subsequent reforms have not adequately address its fundamental

challenges. The value of capital necessary to qualify for the pioneer status has been reviewed over the years and the list of industries/firms has equally been revised but it is not clear, at least not to all potential beneficiaries, how these industries are evaluated.

134. A careful observation shows that some items of the current list of pioneer industries were granted the same status in the1960s. Thus, some industries (sugar, cement and rubber) have been declared as pioneer for upwards of 40 years! This suggests that there is the need for a critical assessment of this incentive in terms of its effectiveness, eligibility and graduation process of firms into non-pioneer category. Table1 presents the list of industries that currently qualify for the pioneer status:

TABLE 1: PIONEER INDUSTRIES AND THEIR PRODUCTS, 2009

	Industry	*Products*
1	Cultivation, processing and preservation of food crops and fruits.	Preserved canned foodstuff and fruits, tea, coffee, refined sugar, tomato puree/juice etc.
2	Integrated dairy production.	Butter, cheese, fluid milk and powder, ice cream (by products, livestock, minor edible products).
3	a) Deep sea trawling and processing b) Coastal fishing and shrimping.	Preserved sea foods, fish and shrimps, fishmeal.
4	Mining lead, zinc, iron and steel from iron ore.	Iron and steel products.
5	Manufacturing of iron and steel from iron ore.	Iron and steel products.
6	The smelting and refining of non-ferrous base metal and the manufacture of their alloys.	Refined non-ferrous base metal and their alloys.
7	Mining and processing of barites, bentonites and associated minerals	Barytes, bentonites and associated minerals
8	Manufacturing of oil well drilling materials containing a predominant proportion of Nigerian raw materials.	Barytes, bentonites and associated minerals.
9	The manufacturing of cement.	Cement, clinker.
10	Manufacturing of glass and glassware.	Sheet glass and laboratory glasswares.
11	Manufacturing of lime from local limestone.	Lime
12	Quarrying and processing of marbles.	Marbles and processed marbles.
13	Manufacturing of ceramic products.	Refractory and heat insulating constructional products, laboratory wares.
14	Formulation and manufacturing of pharmaceuticals.	Pharmaceuticals, health vitamins
15	Manufacturing of yeast, alcohol and related products	Yeast, industrial alcohol and related products.
16	Manufacturing of paper pulp.	Paper pulp
17	Manufacturing of yarn and man-made fibres.	Yarn and synthetic fibres.
18	Manufacturing of machinery involving the local manufacturing of a substantial proportion of the components thereof.	Office and industrial machinery, equipment and apparatus (whether or not electrical).
19	Manufacturing of products made wholly or mainly of mental.	Pipes and tubes structure metal products.
20	Manufacturing of nets from local raw materials.	Fishing nets, mosquito nets and related products.
21.	Manufacturing of gas cylinders. Products	Gas cylinders
22.	The processing of local wheat flour materials	Flour and Offal
23.	Rubber plantation and processing	Rubber
24.	Gum/Arabic plantation and processing	Gum Arabic
25.	Manufacturing of fertilizers Ammonia, Urea	Superphosphate and nitrogenous fertilizers

26.	Vehicle manufacturing	Motor vehicles and motor-cycles, tri-cycles and automotive components
27	Oil palm plantation and processing	Palm oil, palm kennel and offal's
28	Manufacturing of automotive and other components	Automotive and other components
29	Book printing	Books
30	Large scale mechanized farming	Wheat, maize, rice and sorghum
31	Cattle ranching and piggery of not less than 500 herds.	Cattle and pigs of not less than 500 herds.
32	Manufacturing of gypsum	Gypsum
33	Re-refining or recycling of waste oil	Low power oil
34	Manufacturing of electrical appliances/equipment/components and parts.	Generators, transformers, meters, controls, pressing irons, switch gears, test equipment, ballets/starters/lighters, discreet components, resistor/capacitors/coils/semi-conductors/conductors.
35	Ship building, repairs and maintenance of ocean going vessels.	Ships, boats and barges.
36	Manufacturing of computers and clips	Computer hardware and software clips
37	Manufacturing of cameras, photographic equipment and other materials	Cameras, photographic equipment or any components thereof
38	Diving and underwater engineers.	Underwater engineering services.
39	Local fabrications of machinery, equipment.	Machinery
40	Manufacturing of tools	Machines and hand tools
41	Installation of facilities for aircraft manufacturing and the maintenance of aircraft.	Aircraft maintenance and manufacture.
42	Installation of scientific instruments and communication equipment.	Scientific instruments, radio, audio play-back/recorders, loudspeaker units, amplifying systems, microphones, video playbacks/recorders, PBX, telephone handset, tele-printers, trans-receivers, autophones/aerials.
43	Manufacturing of gas and the distribution thereof.	Gas and gas distribution
44	Manufacturing of solar energy powered equipment and gadgets	Solar panels, refrigerators, water pumps, calculators, etc.
45	Large-scale inland fishing farms.	Fish and shrimps
46	Bitumen mining and processing.	Bitumen
47	Salt production	Salt
48	Manufacturing of fire fighting equipment and detection systems.	Fire fighting equipment and detection systems.
49	Manufacturing of cables	Electrical, telephone and other cables
50	Manufacturing of medical equipment.	X-ray, oxygen equipment, etc.
51	Mineral oil prospecting and production	Petroleum
52	Manufacturing of lubricants	Grease, hydraulic/engine oil, gear oil etc.
53	Manufacturing of flat sheets	Flat sheets
54	Manufacturing of oven, cookers, cold rooms, refrigerators, fridges, freezers, air conditioners	Ovens, cookers, cold rooms, refrigerators, fridges, freezers, air conditioners.
55.	Manufacturing of agricultural machinery and equipment.	Ploughs, harvesters, threshers, planters, etc.
56	Manufacturing of material handling and equipment	Cranes, forklifts, etc.

57	Establishment of foundries.	Moulds, casting, etc.
58	Manufacturing of Alum	Alum
59	Manufacturing of enzymes.	Enzymes
60	Manufacturing of concentrates.	Food/fruits concentrates
61	Manufacturing of welding electrodes.	Welding electrodes
62	Manufacturing of nails.	Nails, related items
63	Manufacturing of iron rods.	Rods from billets
64	Manufacturing of hops.	Brewing hops
65	Manufacturing/production of ICT equipment, hardware and software.	Information and communication technology (ICT).
66	Tourism.	Development of holiday resorts, hotels, sporting and recreational facilities.
67	Real Estate Development.	a) Rental income from residential and commercial premises; b) Capital gains from any real estate disposed of within a specified period.
68	Utility services.	a) Independent power generation utilizing gas, coal and renewable energy sources; b) All aspects of transportation such as rail, road and waterways c) Indigenous telecommunications companies other than GSM operations.
69.	Manufacture of basic and intermediate Industrial chemicals from predominantly Nigerian raw materials	i) Basic and intermediate organic chemical; ii) Basic and intermediate in-organic chemicals; iii) Fertilizers; iv) Petro-chemical; v) Caustic soda and chlorine vi) Pesticide and insecticide

135. Between 2002 and 2005, 68 companies were granted pioneer status (Table 2). About half of the companies were fully owned by Nigerians and the other 50% were either joint venture with Nigerian, or foreign owned either jointly between or among national from different countries or fully by nationals of a particular countries. European and Asian countries dominated the list.

TABLE 2: PIONEER STATUS GRANTED TO COMPANIES IN 2002-2005

	Number of Companies	Ownership Structure			Country of Origin
		Fully Nigerians	Joint Venture	Fully Foreign	
2002	22	11	10	1	India, UK, France, Britain, China, Uruguay, Lebanon, Canada
2003	13	6	3	3(1)	USA, India, Greek, Britain, China
2004	20	11	8	1	India, Britain, Lebanon, France
2005	13	6	4	3(1)	Spain, Lebanon, Britain, India, Pakistan

Company Income Tax Relief

136. The current company income tax is 30%. However, Government grants company income tax relief. This general fiscal incentive has been established and evolving over the years. The establishment of this general incentive can also be traced back to pre-independence. Its main features are full exemption from income tax payment such as in the case of companies established in the free trade zones (FTZ)[34] and Biofuel companies[35] to differential rates in terms of reduced tax liability such as in the case of solid mineral sector where is the tax liability is between 20 and 30%.

Accelerated Depreciation

137. Accelerated depreciation is granted in the form of initial and annual allowances varying with the type of asset acquired. The rate of allowable depreciation varies according to different incentives schemes/packages. For example, for export incentives, an additional annual capital asset depreciation allowance of 5% on plant and machinery is granted to manufacturing exporters, who export at least 50% of annual turnover of products with at least 40% local raw material content or 35% of local value added. In the case of solid minerals depreciation or capital allowance granted is 75% of the certified true capital expenditure incurred in the year of investment and 50% in subsequent years. Investment in economically disadvantaged areas has a 100% tax holiday for 7 years with an additional 5% depreciation over and above the initial capital depreciation.

138. The aim of granting firms differential accelerated depreciation is to encourage investment is certain areas and the effect is the reduction the tax base and consequently reduction Government revenue. However, accelerated depreciation is not a guarantee for continuous investment in the sector. Thus, complimentary policy to ensure that firms that benefited from accelerated depreciation plough back the "savings" into the business.

139. Indeed, the effectiveness of general incentives such as investment credits, accelerated depreciation and tax holidays in raising the overall level of investment is dependent on measures designed to raise overall level of saving by the beneficiary

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[34] Companies established in the FTZ are exempted from government levies and rates.

[35] Biofuel companies are exempted from taxation, withholding tax and capital gains tax. Thus sections 78,79, 80 and 81 of the Companies Income Tax Act do not apply to these groups of companies

firms. Hence, measures directed at retention of profit and tax credits for saving are usually used to complement these types of incentives. The goal is to attract high level of savings that would not have been possible without the incentives and to avoid being offset by dis-saving.

Export Incentives

140. Nigeria has pursued a number of initiatives to encourage non-oil exports in the past. These are:

(i) Establishment of special economic zones; and

(ii) Duty drawback system appeared to be very prominent.

141. Although Appendix Table 1 listed twenty (20) different types of incentives, Ogunkola and Bankole (2005) noted that some of these incentives had either been removed or reformed and the list of export incentives has been reduced to about ten (10). Even at that, Nigeria still has the highest number export incentives among countries like Uganda, Malawi, Kenya, Botswana, Zimbabwe and Ghana (ILO, 2000).

142. By October 2003 though, existing schemes were limited to Export Expansion Grant (EEG), Duty Drawback Scheme (DDS) (along with a negotiable duty credit certificate), Manufacture-in-Bond scheme, Export Development Fund Scheme, Pioneer Status Scheme, Counter-trade and Buyback Scheme, and Investment Tax Credit Scheme. Existing export finance and insurance schemes are the refinancing and rediscounting facility, stocking facility, and the industrial export simulation facility. The Export Processing Zone (EPZ) and Export Processing Factories (EPF) constitute other export support arrangements where firms which operate under such status are exempted from all federal, state and local government taxes, levies and duty.

143. The other components of export incentives which are specific only to this package include Export Guarantee and Insurance Scheme (EGIS), Export Adjustment Scheme Fund, and Export Expansion Fund. Others are Duty Draw-back Scheme, Refund of Excise Duty, and Retention of Export Proceeds in Domiciliary Account, Tax Free Interest Earned on Exports Loan, and Rediscounting and Refinancing Facility (RRF).

144. It is doubtful, however, whether the ultimate goal of making non-oil exports the engine of Nigeria's economic growth. There are at least three factors responsible for this variance. One reason is the institutional problem, in the sense that the bodies

responsible for export development in many countries- Trade Promotion Organizations (TPOs) – substantially constrain export growth as a result of red tape, corruption and poor institutional management of the TPOs. According to English and Wulf (2002: 160), "except in Australia, Finland, Ireland, New Zealand, and Singapore, TPOs have not lived up to expectations".

145. The effectiveness of TPOs, they identified, is determined by such factors as the presence of anti-export bias in the overall policy framework and the lack of autonomy from the civil service in terms of TPOs' ability to influence policy and mobilize resources to support export drive. The role of the private sector in defining, implementing and monitoring the TPO strategy is another, along with the need for TPOs to address firm-specific supply conditions along with their traditional offshore activities such as information gathering, market research and trade representation. Other factors are poor staffing; inadequate funding; and lack of periodic self-evaluation to determine the continued relevance and impact of TPOs and their export development strategies.

146. The inability to adequately compensate for the existence of anti-export bias in the overall policy framework, though affecting institutional effectiveness, ensures that export objectives are not matched by export promotion measures. In other words, import policies create a protection level that generates an export bias through incentives to sell on the domestic market. For exports to be attractive, export schemes are then established, but the effectiveness of these schemes in generating the required attraction for exports depends to a large extent on their ability to match and adequately compensate for the consequences of the import policy.

147. Bottlenecks inherent in some incentive schemes, such as the duty drawback scheme, are responsible for their failure. For example, associated administrative costs, cumbersome procedures and delays are the bane of duty drawback schemes (English and Wulf, 2002). Indeed, the administration of duty drawback tends to be difficult at tariff rates greater than 15 or 20 percent (Mitra, 1992). On the other hand, a duty suspension scheme may not find favour with a rentier policy group because it does not involve direct rationing of resources since importers of intermediate inputs for export production under the scheme do not have to pay import duties. To the extent that such benefits accrue only to the exporters, the problem of leakage, which arises when duty-free

intermediate imports are not used for export production, may be amplified for a case to abolish the scheme, hence its inherent predicament.

148. Core export promotion activities as well as trade finance schemes such as pre-shipment export finance guarantee, stocking facility and export stimulation loans have also been faced with inadequacies related mainly to the availability of capital especially in developing countries, which generally face capital shortage. The NEPC confirmed the paucity of funds as follows: "capital subventions are never up to 5% of the actual requirements" (NEPC, 1998: 9) Only ₦28 million and ₦18 million were released respectively in 1995 and 1998 out of ₦700 million and ₦800 million capital grant requests. Therefore, the problems related to the weakness of the financial system to support export finance – specifically the lack of bankable assets and poor access of small export firms to the financial sector – that trade finance measures are created to address substantially remain.

149. The discussion above, though, emphasizes the reasons for not fully realizing export development goals; it does not imply that these schemes have not everywhere facilitated the growth of exports or contributed in one way or the other to the overall growth of the economy. Asian countries, for example, through duty drawback and duty suspension schemes successfully addressed the competitiveness of their exports by allowing their exporting firms import inputs, machinery and components at world prices (see Pangistu, 2002, English and Wulf, 2002). The effectiveness of the schemes resulted in quantum leaps in exports' contribution to their economic growth. In other words, the effectiveness and impact of export support measures on exports, while country-specific, can be appropriately determined through conducting analyses of the pattern of growth of exports in periods subsequent to their introduction.

Free Zones and Regional Fiscal Incentives

150. Free zones, including Free Trade Zones (FTZs) and Free Export Processing Zones (FEPZs), have mushroomed in Nigeria in recent years. The current list of these zones, their locations, operational status and ownership status are presented in Table 3: These zones are spread over the country and hence they are potential means for granting regional incentives. They covered all the geo-political zones of the country. The ownership structure also cut across public (different levels of Government) and private sectors.

TABLE 3: FREE ZONES IN NIGERIA

S/No.	NAME	LOCATION	STATUS	OWNERSHIP
1	Calabar Free Trade Zone (CFTZ)	CRS	Operational	Fed. Govt.
2	Kano Free Trade Zone (KFTZ)	Kano State	Operational	Fed. Govt.
3	Onne oil & Gas Free Zone	River State	Operational	Fed. Govt./Private
4	Lagos Free Zone	Lagos State	Under Cons.	Private
5	Tinapa Free Zone & Tourism Resort	CRS	Under Cons.	Private/Public
6	Olokola Free Zone	Ondo & Ogun	Under Cons.	States/ Private
7	Snake Island Integrated	Lagos	Operational	Private
8	Maigatari Border Free Zone	Jigawa State	Operational	State
9	Banki Border Free Zone	Borno State	Declaration	State
10	Ladol Logistics Free Zone	Lagos	Operational	Private
11	Ibom Science & Tech. Park Free Zone	Akwa Ibom	Under Cons.	Public/Private
12	Living Spring Free Zone	Osun State	Under Cons.	State
13	Airline Services Export Proc. Zone	Lagos State	Operational	Private
14	Lekki Free Zone	Lagos State	Under Cons.	State/ Private
15	Egbeda Free Zone	Oyo State	Declaration	State
16	OILSS Logistics Free Zone	Lagos	Declaration	Private
17	Brass LNG Free Zone	Bayelsa	Under Cons.	Public/Private
18	Abuja Technological Village	Abuja	Under Cons.	Public/Private
19.	Specialized Railway Industrial FTZ Kajola	Ogun State	Under Cons.	Public/Private
20	Imo Guongdong FTZ	Imo State	Under Cons.	Public/Private
21.	ALSCON FPZ	Akwa Ibon	Operational	Private
22	Ogun Guandong Free Trade Zone	Ogun State	Operational	Public/ Private
23	Sebore Farms	Adamawa State	Operational	Private
24	Calabar Free Port	Cross River	Operational	Fed. Govt.

151. Fiscal incentives for free zones in Nigeria include import and export duty exemptions; streamlined customs and administrative controls and procedures; liberal foreign exchange and income tax incentives. Annex 1A contains the list of incentives available to firms in the FTZs in Nigeria. In addition to the country's policy on FTZs, the size of the Nigerian market (as part of the production in the zones can be sold in the Nigerian market, and the potential market in West African market mainly as a result of the integration efforts of the region by the Economic Community of West African States (ECOWAS) and the consideration of available abundant supply of skilled labour at very competitive rates offer a natural advantage to firms locating in the free zones.

152. The free zones are supposed to offer an infrastructural advantage to the firms located in the zones. Perhaps, this is more important in the case of Nigeria based on poor state of infrastructural facilities. It also has implications for its promoters as the development of FTZs requires huge investment and commitments necessary to ensure that firms located in the zones are competitive.

153. Currently, the list of industries operating in the FTZs which are based on individual merit and thus offer opportunity to other equally important industries that are not currently listed are as follows:

(i) Electrical and Electronic Products;
(ii) Textile Products;
(iii) Garments;
(iv) Wood Products and Handicraft;
(v) Leather Products;
(vi) Petroleum Products;
(vii) Rubber and Plastic Products;
(viii) Cosmetics and other Chemical Products;
(ix) Metal Products and Machinery;
(x) Educational materials and Sports Equipment;
(xi) Printing Materials, Communication and Office Equipment;
(xii) Medical Kits, Optical Instruments and Appliances;
(xiii) Biscuits, Confectioneries and other Food Processing;
(xiv) Pharmaceutical Products;
(xv) Ship building and Repairs; and
(xvi) Oil and gas Logistics.

154. Two administrative and supervising bodies for the FTZs are the Nigerian Export Processing Zones Authority (NEPZA) and the Oil and Gas Export Free Trade Zone (OGFZA). The rationale for having two bodies has been raised by the Presidential Technical Committee on the Review of Incentives, Waivers, and Concessions. The Committee further observed that there are misconceptions about the various incentives issues especially as they relate to firms located in the zones. A serious issue raised by the Committee is the poor state of most of the FTZs in Nigeria especially the infrastructural decay. There is therefore the need to raise the standard of FTZs in Nigeria and to ensure high quality and well functional Zones.

155. The application of regional incentives in Nigeria has been subsumed under various incentives such as the pioneer status granted on the basis of a firm's location in economically disadvantage areas. The current incentive system has no definite role or place for the other tiers of governance. The states have, however, been very active in

the establishment of FTZs. It may be useful to establish a benchmark for incentives in FTZs and state governments may consider additional incentives to attract investors to the different Zones.

Modalities and Institutional Challenges

156. The long list of incentives is equally matched by the long list of institutions established to administer them. For example, administration of export incentives in Nigeria involves the following Ministries, Departments and Agencies of the Federal Government:

(i) Nigerian Export Promotion Council (NEPC);
(ii) Nigerian Export Processing Zones Authority (NEPZA);
(iii) Nigerian Export Import Bank (NEXIM);
(iv) Nigerian Customs Service;
(v) Commercial Banks;
(vi) Standard Organisation of Nigeria (SON);
(vii) Federal Ministry of Commerce and Industry;
(viii) Federal Inland Revenue Service (FIRS);
(ix) Federal Ministry of Finance;
(x) Central Bank of Nigeria;
(xi) Pre-shipment Inspection agency; and
(xii) Nigerian Investment Promotion Council.

157. The procedure for accessing the incentives is neither simple nor transparent. For example, the revised guidelines for export expansion grant (EEG) scheme required between 9 and 14 documents and involved layers of Committee meetings before approval is granted.

ToR2: Review Existing Studies on Fiscal Incentives, with particular focus on their Impact and Limitations.

158. Based on available data, Ogunkola and Bankole (2005) analysed different types of export support programmes: the Export Expansion Grant (EEG), Duty Drawback Scheme (DDS), Rediscounting and Refinancing Facility (RRF) and Stocking Facility (SF) and the observed patterns suggest at least four implications:

(i) More firms benefit from EEG than any other scheme under comparison;
(ii) Trade finance support tends to provide more funds for firms on the average;

(iii) The low number of beneficiaries and amounts under the DDS point to problems relating to administrative red tape in the administration of the scheme rather than inadequate funds to support it; and

(iv) The high average amount per firm under the RRF/SF scheme may have been provided to large export firms.

159. There is no doubt that the most prominent export incentive system used since 1986 is the Export Expansion Grant (EEG). This subsidizes exports of qualifying companies through the issuance by Customs of negotiated certificate that can be redeemed against duties on imports. In most cases export incentives are usually pursued with a view to generate foreign exchange and to strengthen the balance of payment position. This appears not to be the main goal of granting export incentives in Nigeria as diversification of foreign exchange earnings from oil and therefore the promotion of non-oil exports is of the primary concern.

160. In any case effectiveness of export incentives should be related to at least the following three parameters:

(i) Total foreign sales;

(ii) Profits from foreign sales; and

(iii) Domestic value addition.

Indeed, to ensure that firms are not engaged in re-export business, domestic value addition should be the standard parameter for evaluating effectiveness of this policy.

161. The size of the subsidies of up to 30% of export value and the lack of control has given rise to widespread fraud, such as over-invoicing of exports, while supply response from actual or potential exporters is unclear. There is the need to evaluate the use of EEG funds and to assess if and to what extent it achieves its stated objective. More generally, a broader review of export incentives schemes would seem highly desirable in order to rationalize the Government's support to exporters, improve its efficiency, and minimize the risk of abuse.

162. Phillips, (1967) concluded that based on administrative convenience and equity Approved User Scheme (AUS) is a much more effective and efficient procedure than Import Duties Relief (IDR). He even advocated for the replacement of IDR with AUS. Despite the preference of AUS over IDR he submitted that effectiveness of AUS could be enhanced by making it more selective. He also suggested the need to improve on

- the efficiency of administrative procedure in particular harmonization of process between the Federal Ministry of Finance and the Federal Ministry of Industry.

163. Tax exemption, as an instrument of industrial policy, has been criticized as an ineffective and inefficient stimulus to investment because it is against the equity principle of taxation, complicating the regular tax system and increasing avenue for tax evasion. This coupled with complication and complex procedure of administration, Phillips (1968) advocated that the pioneer companies' relief pogramme be abolished and that tax incentive policy could then concentrate on relief from import duties. Or retained the pioneer companies' relief programme but rationalize it by reducing its cost in terms of revenue and enhance its effectiveness. He suggested that it could be made more selective in order to tie assistance more closely to need and to encourage only those enterprises which are vital to the economy's development. He opined that it would be necessary to introduce a provision for terminating the relief once it appears superfluous by (1) limiting the relief to a certain percentage of investment, so that profit in excess of this percentage would attract tax and or the relief period could be limited in particular cases to the period taken to recoup the initial investment of the company.

164. On fiscal incentives to Pioneer Industries, Asiodu (1967) advised on the need:

(i) For greater selectivity in the granting of pioneer certificates;

(ii) To remove of any appearance of arbitrariness in the granting of Pioneer Certificates;

(iv) To ensure that high-cost inefficient local firms are not inadvertently promoted, i.e. not to protect inefficient firms at the expense of more efficient ones; and

(iv) To ensure that local value added are promoted.

165. Nwokoma (2002) based on micro analysis submitted that lack of coordination of policies renders some of the fiscal incentives either less effective or ineffective. He suggested the need for setting benchmark performance expectations for firms as a pre-condition for continuous granting of incentives.

166. A comparative study of fiscal incentives in Nigeria, South Africa and Kenya reveals that there is a confusing maze of government regulations which alter, override and, in some cases, operate outside the statutory tax system, which is often unclear and opaque in many respects (Oyetunde, 2006). He equally observed that the South African fiscal and tax incentive system as generally better administered with clear

policy objectives and targeted tools to achieve these objectives. He went further to characterise Kenya tax and incentive system as predominantly focussed on the export-oriented, textile and agro allied sectors.

167. Other recent studies that have examined fiscal incentives in Nigeria include IMF (2008) and the Presidential Committee on Concessions, Waivers and Incentives (2009). The former's recommendations are outlined in the table below

TABLE 4: IMF'S RECOMMENDATIONS

INCENTIVES	*RECOMMENDATION*
Corporate income tax	The CIT should be reduced to 25 percent, possibly over three years
Tax holiday	Nigeria should not offer new tax holidays. Instead, Nigeria should rely on a low tax rate, accelerated capital allowances and its unlimited loss carry forward to provide an incentive for investment
Capital allowances	Nigeria should adopt a simplified system of annual capital allowance system based on open-ended accounts – enabling grouping individual assets into "pools"
Export Processing Zones and Free Zones	(a) When goods are exported from EPZs or free zones to domestic market, VAT should be charged on the full value of the goods, and (b) Companies operating in EPZs and free zones should not be granted tax holidays

168. Some of the recommendations of the Presidential Committee are as follows:

(i) All incentives, waivers and concessions that are used to run the country's economy need to be legislated and passed into laws with specified time frames and should have rewards and sanction attached to them;

(ii) The structure and administration of a recommended incentive should be simple and easily understood to ensure clarity of procedures and a quick turn-around time of all applications made since urgency and timeliness of approvals are essential for attracting and retaining investors;

(iii) Granting of incentives should be done in accordance with predetermined transparent and uniform criteria or guidelines. Any approved and granted incentive should be open to public knowledge and should be properly and widely publicised, and predictable in its application;

(iv) The reduction of company tax rates to a maximum of 20% in recognition of the inadequacy of infrastructure and the phasing out of grants to pioneer status;

(v) The Export Expansion Grant (EEG) should be retained to principally focus on rewarding incremental exports and to be periodically reviewed and updated;

(vi) Any prospective investor willing to create a free trade zone of the same quality, and meeting the international standards, which TINAPA is believed to have met, should be granted similar concessions;

(vii) Credit incentives should be harmonised and made accessible to small and medium scale enterprises (SMEs) to facilitate their growth;

(viii) The investment incentives should be prioritised and should be driven by national interest; and

(ix) The country's incentive structure should be regularly reviewed to ensure relevance and effectiveness, impact assessment of all approved incentives will allow for continuous modifications, relevance and improvements.

Limitation of Fiscal Incentives

169. To what extent can fiscal incentives promote the goal of high level of investment and direct investment to areas of interest? Fiscal incentives are just one of the components that influence investment decision. For foreign investors where the world is the investment space, different weights are assigned to different factors. Thus other factors apart from fiscal incentives have been shown as the real motivation for firms establishing in a particular country including Nigeria. For example, it very hard to justify the relocation of firms from Nigeria to neighbouring West African countries on the basis better fiscal incentives. Although Nigeria offered a very large market to producers, the country may also be a reliable source of raw materials; availability of cheap labour. However, poor state of infrastructure may be a consideration. There is a limit to trading-off basic investment location factors with the offer of fiscal incentives. See Box 2a: case against tax incentives.

The case against tax incentives:

(i) Tax incentives by their nature are inequitable and inefficient. They create effective tax rates that vary both between and within sectors and thus misallocate resources;

(ii) Tax incentives involve a loss of current and future tax revenues. If a revenue target must be achieved, taxes must be higher on other activities, further distorting the allocation of resources;

(iii) Although taxes are important they are not the most important factor in investment decisions. Economic stability, adequate infrastructure, natural resources, trained labour force, and clean government are all more important;

(iv) Tax incentives are not as important as certainty and simplicity in the operation of the tax system. As long as taxes are moderate and the tax system well administered, a system without special incentives is more attractive to investors than one that regulates market choices through special provisions;

(v) Tax incentives are not an effective way of attracting foreign investment. If the home country taxes repatriated profits (the United States and United Kingdom, for example), a tax incentive granted by the source country may simply reduce the foreign tax credit that would have offset the home country's tax, resulting, in effect, in a transfer from the source country to the home country;

(vi) Experience in other countries shows that income tax holidays or tax exemptions are a particularly inefficient way to promote investment in new enterprises, which typically are unprofitable in the early years and thus unlikely to benefit. The principal beneficiaries are more likely to be those companies that are profitable from the outset and might not need incentives;

(vii) When tax holidays expire, the assets of the holiday company may be sold to a new company qualifying for a new tax holiday. Tax authorities find it difficult to police such abuses.

Source: IMF (2008)

ToR3: Examine the Fiscal Incentives of Selected Rapid-growth and Diversified Emerging Economies with a view to adapting them to suit the Nigerian situation.

170. The fiscal incentive regimes in the following countries were examined with a few to draw some lessons: Angola, Brazil, China, India, Mauritius, and South Africa. Evidence suggests that fiscal incentives in these countries are dynamic as they changed over the years. For example, Mauritius had over the years introduced numerous incentive schemes, on an *ad hoc* basis, many of them overlapping. These incentives ranged from customs duty and VAT exemptions to a reduced corporate tax of 15 percent (instead of the standard rate of 25 percent). According to the Government, the numerous tax breaks and exemptions had made the system very complex and

offered vast opportunities for abuse and tax avoidance, and led to inefficiency and bias against small enterprises.[36] Therefore, the Government changed its investment promotion strategy to low-tax regime and promotion of targeted projects in 2006.

171. Brazil's incentives and other Government assistance for production and investment, in general, is granted mostly through official credit at rates significantly below market rates, and in some cases are linked to local-content requirements. Brazil also provided incentives for regional development through the free trade zones. Incentives and Government assistance are provided both at the Federal and at the State level. Incentives programmes can be regional, aimed at developing research, or targeted at specific sectors.

172. Three (3) of such incentives programmes are:

(i) The regional programmes designed to reduce economic and social imbalances between regions by means of compensatory mechanisms for the development of the selected regions (Amazon and north-east regions and for the state of Espírito Santo);

(ii) Free-trade zones for imports and exports, defined as zones created to promote the development and regional integration of border areas in the north region, for which they are granted fiscal incentives. Eight free-trade zones have been created However, only one of them is engaged in production operations; the others engage only in commerce operations. The FTZ was established in 1967 with the goal of creating a development pole in the Amazon region through the formation of an industrial park, which would turn the targeted region into an industrial, commercial, and agriculture centre with economic conditions to promote the development of the region; and

(iii) Brazil's Ministry of Science and Technology is responsible for the administration of R&D programmes and incentives. Since 1999, the scientific and technological development support funds comprise the main R&D financing mechanism in Brazil. There are 16 such funds, each corresponding to a specific area and with its own resources, which stem from direct contributions or from other revenues from the different sectors, such as royalties, taxes, licenses, and authorizations (Table 5).

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[36] Republic of Mauritius (2007).

173. India's tax incentives are provided "with a view to improving the foreign exchange reserves of the country".[37] Direct tax incentives to exporters include a 100 percent tax deduction for ten (10) years for export profits of manufacturers of goods or computer software located in a special economic zone, Export Processing Zone, Free-Trade Zone, Electronic Hardware Technology Park, or Software Technology Park. Some new companies operating in the Zones were given a further deduction of 50 % of profits credited to a Special Economic Zone Re-investment Allowance Reserve Account to be used for acquiring new plant or machinery, to be used within three (3) years[38].

174. India's fiscal incentives gives special treatment to Foreign-Invested Enterprises (FIEs) established in the special economic zones, and state economic and technology development and hi-tech development zones, as well as coastal open cities and areas, and the western areas. The zones have been used to attract foreign investment, including through lower tax rates to promote export processing. The details of the Scientific and Technology Development Support Funds are shown in table 5 below:

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[37] WTO document G/SCM/N/71/IND, 19 October 2001.

[38] However, until the acquisition of the new plant or machinery, the reserve may be used by the undertaking (other than for distribution through dividends or profits or for remittance outside India as profits, or for the creation of any asset outside India). This deduction is available for three years.

TABLE 5: SCIENTIFIC AND TECHNOLOGICAL DEVELOPMENT SUPPORT FUNDS, 2008

Fund/law	Resources
Petroleum and Natural Gas Fund (CT-PETRO), Law No. 9,478 of 6 August 1997	25% of the share of the value of royalties, which exceed 5% of the production of petroleum and natural gas
Energy Fund (CT-ENERG), Law No. 9,991 of 24 July 2000	0.75% to 1% of the net turnover of concessionaries for the generation, transmission, and distribution of electricity
Hydric Resources Fund (CT-HIDRO), Law No. 9,993 of 24 July 2000	4% of the income of electricity generation companies
Land Transport Fund (CT-TRANSPORTES), Law No. 9,992 of 24 July 2000	10% of the revenues obtained by the National Transportation Infrastructure Department (DNER) from contracts for land transport services with communications and telecommunications companies
Mining Fund (CT-MINERAL), Law No. 9,993 of 24 July 2000	2% of the income of the mining sector
Spatial Fund (CT-ESPACIAL), Law No. 9,994 of 24 July 2000	25% on operations and revenue from licences and authorizations of the Brazilian Space Agency (AEB).
Telecommunications Technology Development Fund (FUNTTEL), Law No. 10,052 of 28 November 2000	0.5% on telecommunications providers bills and 1% on bills of participative events carried out through telephone calls
Information Technology Fund (CT- INFO), Law No. 10,176 of 11 January 2001	0.5% on informatics enterprises' bills
University and Enterprise Fund (CT-VERDE AMARELO), Laws Nos. 10,168 and 10,332 of 29 December 2000 and 19 December 2001	50% of the CIDE and 43% of the IPI on informatics-related products
Infrastructure Fund (CT-INFRA), Law No. 10,197 of 14 February 2001.	20% of other funds
Water Transport and Naval Construction Fund (CT-Aquaviário). Law No. 10,893 of 13 July of 2004.	3% of the AFRMM for the Merchant Marine Fund (FMM)
Amazon Fund (CT-AMAZÔNIA); Law No. 8,387 of 30 December 199, Law No. 10,176, of 11 January 2001, and Decree No. 4,401, of 1 October 2002	At least 0.5% of the bills of companies operating in the Manaus Free Trade Zone that produce informatics-related goods and services
Biotechnology Fund (CT-Biotecnologia); Agri-business Fund (CT-AGRONEGÓCIO); Aeronautical Fund (CT-AERONÁUTICO), Health Fund (CT SAÚDE), Law No. 10,332 of 29 December 2001	17.5% of proceeds collected by the CIDE to be devoted to the Agri-business Fund; 17.5% to the Health Fund; 7.5% to the Biotechnology Fund; and 7.5% to the Aeronautical Fund

Source: **Information provided by the Brazilian authorities.**

TOR4: Recommend Appropriate Changes in Nigeria's Fiscal Incentives, with the objectives of Enhancing Productivity in the Real Sector, promoting greater Diversification, and Facilitating Rapid Economic Growth and Development.

175. Many options on the future of fiscal incentives are available; however, two of them are presented: First, is to phase out the current regime of incentives, i.e. stop granting new incentives and allow those that are already granted to terminate at the expiry date. Since there will always be clamour for incentives, a general incentive to all the manufacturing firms of, say, 5% reduction in the current rate of company income tax may be introduced. This will place all the firms on equal footing. This suggestion is not new, as IMF (2008) and the Presidential Committee on Incentives, Concessions and Waivers (2009) had suggested same. This may be sufficient incentive to attract and or retain firms especially those that are desirous to locate within the West Africa sub-

region[39]. Indeed, Nigeria's current company income tax rate compares favourably with regional rates[40]. However, there is the need to evaluate the impact of such reduction on the fiscal revenue of the Government. In this case, the tax avoidance occasioned by the complexities introduced by the administration of fiscal incentives would be minimized.

176. Another option is to significantly reform the fiscal incentives in the country to make it more selective, national goal oriented, transparent and devoid of cumbersome and complex administrative procedure. Some of the elements of the reforms are as follows:

(i) The list of incentives needs to be greatly pruned down to manageable level and targeted at a few carefully selected sectors based on the national priorities and growth objectives;

(ii) There is also the need to rationalize list of incentive granting bodies. It may be convenient in the short run to ensure effective coordination and harmonization of activities of these bodies but the ultimate goal is to have only one body responsible for the administration of fiscal incentives in the country. The rationalization of the list of incentives as well as granting bodies is among to promote efficiency and check cases of abuse such as double dipping;

(iii) The procedures and processes for granting fiscal incentives need to be revised along the following lines:

- The process and criteria for granting different incentives must be clearly stated and readily available and accessible to all stakeholders.
- Rather than individual firms competing among themselves to have access to a particular set of incentives, the government should consider granting the incentives to groups of stakeholders (automatic versus discretionary incentives).

(iv) Evaluation and monitoring of fiscal incentives granted should be on regular basis to:

- Ascertain the achievement of targeted goals.

[39] As noted earlier, fiscal incentives are not the priority in investment decision of firms.
[40] The current company income tax rates are 35% for Cote d'Ivoire, 32% for Mozambique, 30% for Kenya, Tanzania and Uganda, 25% for Ghana.

- ❖ Check for potential abuses.
- ❖ Ascertain the costs and benefits incentives especially in relation to administrative costs and also forgone Government revenue.

(v) Free Trade Zones have potentials for driving the growth and development of the Nigerian economy and their added advantages include amenable to regional incentives, makes tax administration is easier because benefiting firms are located in zones. However, these zones must be properly established and efficiently administered especially the basic infrastructure must be in place and well maintained. To ensure optimal functioning of these zones, the establishment, operations, and management should be thoroughly reviewed with a view to:

- ❖ Ensure that the business environment in the zone meets international standard.
- ❖ Double dipping and other sharp practices are minimized.
- ❖ Differential and preferential incentives may be considered to address regional development issues. For example, firms locating in a zone that is located in an economically disadvantage area may be granted additional incentives or preferential rates than what obtains in other zones.
- ❖ Currently there are two Authorities responsible for administering FTZs in the country. There is the need to merge them to avoid unnecessary duplication and minimise costs.

Committee's Finding on Fiscal Incentives

177. The Committee's findings on fiscal incentives include the following:

(i) Objectives of fiscal incentives may not have been properly articulated due to multiplicity of incentives;

(ii) The procedures and modalities for granting incentives are complex because of too many Agencies are involved;

(v) It appears that not all stakeholders have full knowledge of available fiscal incentives system in the country;

(vi) More firms benefit from Export Expansion Grant Scheme (EEG) than any other schemes under comparison;

(vii) Trade Finance Support tends to provide more funds for firms on the average;

(viii) The low number of beneficiaries and amounts under the Duty Drawback Scheme (DDS) point to problems relating to red-tapeism in the administration of the scheme rather than inadequate funds to support it;

(ix) The high average amount per firm under the Rediscounting and Refinancing Facility (RRF)/ Stocking Facility (SF) scheme may have been provided to large export firms;

(x) The Presidential Committee on the Review of Incentives, Waivers and Concessions made some recommendations especially on how to reform fiscal incentives. Government has accepted most of the recommendations;

(xi) Nigeria has the highest number of export incentives among countries like Uganda, Malawi, Kenya, Botswana, Zimbabwe and Ghana;

(xii) The system of fiscal incentives in Nigeria is lacking in focus and poorly administered unlike the systems in South Africa and Kenya which are characterized with clear policy objectives and targeted tools;

(xiii) Fiscal incentives in most countries are dynamic as they are reviewed regularly. For instance, the Mauritius Government reformed its tax incentive system in 2006 by changing from numerous tax breaks and exemptions to a low-tax regime and promotion of targeted projects. The regime before the reform in 2006 was very complex and created vast opportunities for abuse and tax avoidance and thus created inefficiency and bias against small enterprises;

(xiv) Two main characteristics of Brazil's incentives regime provide Nigeria with useful lessons; the dominant use of official credits at rates below the market rate and often linked to local content requirements, and Incentives for regional development are through free trade zones (FTZs);

(xv) Taxes are important but they are not the most important factor in investment decisions. Economic stability, adequate infrastructure, natural

resources, human capital, and efficient delivery of public goods are all the more important;

(xvi) Tax incentives are not as important as certainty and simplicity in the operation of the tax system. As long as taxes are moderate and the tax system well administered, a system without special incentives may be more attractive to investors than one that regulates market choices through special provisions;

(xvii) Tax incentives are not an effective way of attracting Foreign Direct Investment as the home may tax repatriated profits and thus result in an unintended transfer from the source country to the home country;

(xviii) Income Tax Holidays or Tax Exemptions are a particularly inefficient way to promote investment in new enterprises, which typically are unprofitable in the early years and thus unlikely to benefit. The principal beneficiaries are more likely to be those companies that are profitable from the outset and might not need incentives;

(xix) Fiscal incentives are used essentially to transfer resources from the general group to a specific sub-group e. g, the cost of fiscal incentives is borne by all tax-payers, while the benefits tend to accrue to particular sub-groups;

(xx) Cost- benefit analysis of these incentives is not feasible because of lack of data; and

(xxi) Performance of the non-oil sector has not been significant even from the benefit side.

Committee's Recommendations on Fiscal Incentives:

Phase out the Current Regime of Incentives

178. The Committee has recommended the need to stop granting new incentives and allow those that are already granted to terminate at the expiration date. Since there will always be clamour for incentives, a general incentives to all the manufacturing firms of, say, 5% reduction in the current rate of company income tax may be introduced. This will place all the firms on equal footing. This suggestion is not new as IMF (2008) and the Presidential Committee on Incentives, Concessions and Waivers (2009). This may be sufficient incentive to attract and or retained firms especially those that are desirous

ANNEXES

ANNEX 1: FREE TRADE ZONES

In addition to the above, Nigeria's FTZ regulatory regime is liberal and provides a conducive environment for profitable operations. The incentives available are among the most attractive in Africa and compares favourably with those in other parts of the world. These include:

(i) Exemption from all federal, state and local government taxes, levies and rates;

(ii) Approved enterprises shall be entitled to import into a zone, free of customs duty on capital goods, consumer goods, raw materials, components and articles intended to be used for purposes of and in connection with an approved activity;

(iii) Freedom from legislative provision pertaining to taxes, levies, duties and foreign exchange regulations;

(iv) Repatriation of foreign capital on investment in the zone at any time with capital appreciation of the investment;

(v) 100% foreign or local ownership of factory allowable;

(vi) One stop approvals which grant all licenses whether or not the business is incorporated in the Customs Territory;

(v) Unrestricted remittance of profits earned by investors;

(vi) Permission to sell 100% of total production in the domestic market;

(vii) No import or export license.

(viii) Rent free land at construction stage, thereafter rent shall be as determined by the management of the zone. Foreign managers and qualified personnel may be employed by companies operating in the zones; and

(xi) Operations within a zone shall commence on the date when the constructions of the perimeter fence and gate have been completed and the Authority has declared it so.

regular basis to:

- Ascertain the achievement of targeted goals.
- Check for potential abuses.
- Ascertain the costs and benefits incentives especially in relation to administrative costs and also forgone Government revenue.

(v) To minimize abuse and increase both efficiency and effectiveness of the fiscal incentive, the design of fiscal incentives should:

- Limit their scope.
- Reduce discretionary criteria for granting them.
- Ensure transparency and predictability.
- Place the burden of proof on the beneficiaries to establish that they do indeed remove ascertainable negative externalities and/or induce positive ones.

(vi) Free Trade Zones have potentials for driving the growth and development of the Nigerian economy and their added advantages include amenable to regional incentives, makes tax administration is easier because benefiting firms are located in zones. However, these zones must be properly established and efficiently administered especially the basic infrastructure must be in place and well maintained. To ensure optimal functioning of these zones, the establishment, operations, and management should be thoroughly reviewed with a view to:

- Ensure that the business environment in the zone meets international standard.
- Double dipping and other sharp practices are minimized.
- Differential and preferential incentives may be considered to address regional development issues. For example, firms locating in a zone that is located in an economically disadvantage area may be granted additional incentives or preferential rates than what obtains in other zones.
- Currently there are two Authorities responsible for administering FTZs in the country. There is the need to merge them to avoid.

to locate within the West Africa sub-region[41]. Indeed, Nigeria's current company income tax rate compares favourably with regional rates[42]. However, there is the need to evaluate the impact of such reduction on the fiscal revenue of the Government. In this case, the tax avoidance occasioned by the complexities introduced by the administration of fiscal incentives would be minimized.

Reform the Fiscal Incentives in the Country

179. The reform will make the fiscal incentives in the country more selective, national goal oriented, transparent and devoid of cumbersome and complex administrative procedure. Some of the elements of the reforms are as follows:

(i) The list of incentives needs to be greatly pruned down to manageable level and targeted at a few carefully selected sectors based on the national priorities and growth objectives;

(ii) There is also the need to rationalize list of incentive granting bodies. It may be convenient in the short run to ensure effective coordination and harmonization of activities of these bodies but the ultimate goal is to have only one body responsible for the administration of fiscal incentives in the country. The rationalization of the list of incentives as well as granting bodies is among to promote efficiency and check cases of abuse such as double dipping;

(iii) The procedures and processes for granting fiscal incentives need to be revised along the following lines:

- ❖ The process and criteria for granting different incentives must be clearly stated and readily available and accessible to all stakeholders.
- ❖ Rather than individual firms competing among themselves to have access to a particular set of incentives, the government should consider granting the incentives to groups of stakeholders (automatic versus discretionary incentives).

(iv) Evaluation and monitoring of fiscal incentives granted should be on

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[41] As noted earlier, fiscal incentives are not the priority in investment decision of firms.

[42] The current company income tax rates are 35% for Cote d'Ivoire, 32% for Mozambique, 30% for Kenya, Tanzania and Uganda, 25% for Ghana.

ANNEX 2: VARIOUS INCENTIVES ON OFFER TO STIMULATE BIOFUEL INDUSTRY

With vast areas of arable land and an excellent climate for the cultivation of various crops, Nigeria has good potential for biofuel production. The objective of Nigeria's Biofuel Production Programme is to establish a thriving fuel ethanol industry by utilising agricultural products. A number of incentives have been introduced to stimulate Nigeria's biofuel industry. These include:

Pioneer Status

All registered businesses engaged in activities related to biofuels production and/or the production of feedstock for the purpose of biofuel production and co-generation within the country shall be accorded Pioneer Status within the provisions of the Industrial Development (Income Tax Relief) Act.

Withholding Tax on Interest, Dividends, etc.

Biofuel companies shall be exempted from taxation, withholding tax and capital gains tax imposed under sections 78, 79, 80 and 81 of the Companies Income Tax Act in respect of:

(i) Interest on foreign loans,;

(ii) Dividends; and

(iii) Services rendered from outside Nigeria to biofuel companies by foreigners.

Waiver on Import and Customs Duties

Biofuel companies shall be exempted from the payment of customs duties, taxes and all other charges of a similar nature, specifically:

(i) Biofuel companies shall be exempted from the payment of duties and other related taxes on the importation and exportation of biofuels into and out of Nigeria. Exemption from payment of import duties on biofuels is aimed at ensuring adequate supply of biofuels in line with regulations as it relates to the importation of petroleum products. Biofuel companies shall be exempted from payment of excise duties on biofuels for an initial 10-year period subject to renewal depending on prevailing circumstances; and

(ii) Biofuel companies and their contractors and subcontractors shall be exempted from the payment of import duties, taxes and all other duties, levies

and charges of a similar nature, in respect of all necessary imports of plant machinery, goods, chemicals, fertilisers, pesticides and materials for use in the construction of, or incorporation in milling plants, mechanised agricultural production (such as tractors, harvesters, haulers, irrigation equipment, etc.), infrastructure for biofuels transportation, co-generation facilities and ancillary works used in biofuel company business, and in respect of any major spare parts.

Waiver on Value Added Tax

Biofuel companies that are involved in the production of biofuels feedstock; or the production of biofuels and/or the generation of electricity from biomass shall be exempted from payment of Value Added Taxes on all products and services consumed by them.

Long Term Preferential Loans

(i) Preferential loan arrangements will be made available to investors in the biofuel industry to aid the development of large scale outgrower schemes and large scale integrated operations, including a plantation, a plant, and within the gate co-located power generation plants. The domestic financing of industrial production for the biofuel industry shall be aided through the provision of special low interest loans provided by the Bank of Industry, Nigerian Export Import Bank, commercial banks, agricultural banks, and other development finance agencies.

(ii) Preference in loan disbursement will be given to investors/organisations with commercially viable outgrower schemes as a source of significant feedstock supply for biofuel production.

(iii) An Environmental Degradation Tax shall be charged on oil and gas upstream operations to provide a source of funding for preferential loans.

(iv) A fund of N10-billion has been set aside by the government for provision of preferential loans for investment in biofuel distilleries to complement the N50-billion set aside for the agricultural sector on similar terms of a single-digit interest rate.

(v) Preferential loan facilities shall be administered by the Central Bank of Nigeria through commercial and agricultural banks.

(iii) Investment tax credit at the current rate of 5%; and

(iv) Royalty at the rate of 7% onshore and 5% offshore.

Gas Transmission and Distribution:

(i) Capital allowance as in production phase above;

(ii) Tax rate as in production phase; and

(iii) Tax holiday under pioneer status.

LNG Projects:

(i) Applicable tax rate under Petroleum Profit Tax (PPT) is 45%;

(ii) Capital allowance is 33% per year on-straight line basis in the first three years with 1% remaining in the books;

(iii) Investment tax credit of 10%; and

(iv) Royalty 7% onshore and 5% offshore, tax deductible.

Gas Exploitation (Upstream Operation):

Fiscal arrangements are reviewed as follows:

(i) All investments necessary to separate oil from gas from reserves into suitable product is considered part of the oil field development;

(ii) Capital investment facilities to deliver associated gas in usable form at utilization or transfer points will be treated for fiscal purposes as part of the capital investment for oil development;

(iii) Capital allowances, operating expenses and basis for assessment will be subjected to the provisions of the PPT Act and the revised Memorandum of Understanding (MOU);

Gas Utilization (Downstream Operation)

(i) Companies engaged in gas utilization are to be subjected to the provisions of the Companies Income Tax Act (CITA);

(ii) An initial tax free period of three years renewable for an additional two years;

(iii) Accelerated capital allowances after the tax-free period in the form of 90% with 10% retention in the books; and

(iv) 15% investment capital allowance, which shall not reduce the value of the asset.

In 1998, the Government approved additional incentives to support the gas industry in the following areas:

ANNEX 3: SMALL AND MEDIUM ENTERPRISES EQUITY INVESTMENT SCHEME

The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) is an initiative of the Bankers' Committee. The initiative was in response to the federal government's concerns and policy measures for the promotion of small and medium enterprises (SMEs) as vehicles for rapid industrialization, sustainable economic development, poverty alleviation and employment generation. The Scheme requires all banks in Nigeria to set aside 10% of their Profit After Tax (PAT) for equity investment and promotion of small and medium enterprises. Funding to be provided under the scheme shall be in the form of loans or equity investment or a combination of both in eligible enterprises.

Activities covered by the scheme

Every legal business activity is covered with the exception of:

(i) Trading/merchandising; and

(ii) Financial Services.

Definition of a Small and Medium Enterprise

For the purpose of this scheme, a Small and Medium Enterprise is defined as any enterprise with a maximum asset base of N1.5 billion (excluding land and working capital), and with no lower or upper limit of staff. This is subject to review by the Bankers' Committee from time to time.

Eligibility for Funding

To be eligible for funding under the Scheme, a prospective beneficiary shall:

(i) Comply with the provisions the Companies and Allied Matters Act (1990) such as filing of annual returns, including audited financial statements; and

(ii) Comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities.

Modalities of the Scheme

(i) Funds invested by participating banks shall be in the form of loans or equity investment or a combination of both in eligible enterprises; and

(ii) Interest on loan shall be single digit subject to a maximum of 9%.

Maximum amount investible in any Enterprise

The maximum amount investible in any enterprise is limited to 20% of the bank's annual set aside funds subject to a maximum of N500-million.

Deadline for Investing Funds/Investment Exit

(i) The time limit to invest the funds set-aside shall be 12 months after the AGM of the bank; and

(ii) Banks shall remain equity partners in the business enterprises for a minimum of 3 years after which they may exit anytime.

Requirements by Beneficiaries

Beneficiaries will be expected to:

(i) Ensure prudent utilization of funds;

(ii) Keep up-to-date records on the companies' activities under the Scheme;

(iii) Make the companies books, records and structures available for inspection by the appropriate authorities (including banks and the CBN) when required;

(iv) Comply with guidelines of the Scheme; and

(v) Provide monthly financial and operational reports to the investing banks before the 15th of the next succeeding month.

The recommendations of industrial associations, particularly Manufacturers Association of Nigeria (MAN); National Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA); National Association of Small and Medium Scale Enterprises (NASME); and National Association of Small Scale Industrialists (NASSI) will be mandatory for members of these associations. Membership of recognized NGOs engaged in entrepreneurial development and promotion of small and medium scale enterprises will also be an advantage.

ANNEX 4: TAX INCENTIVES TO THE GAS INDUSTRY

Gas Production Phase:

(i) The applicable tax rate is the same as the company income tax which is currently at 30%;

(ii) Capital allowance at the rate of 20% per annum is given in the first four years, 19% in the fifth year and the remaining 1% in the books;

(i) All gas developmental projects, including those engaged in power generation, liquid plants, fertilizer plants, gas distribution/transmission pipelines are taxed under the provisions of Companies Income Tax (CITA) and not the PPT;

(ii) All fiscal incentives under the gas utilization downstream operations since 1997 are to be extended to industrial projects that use gas, i.e. power plants, gas to liquids plants, fertilizer plants, and gas distribution/transmission plants;

(iii) The initial tax holiday is to be extended from three years to five years;

(iv) Gas is transferred at 0% PPT and 0% royalty;

(v) Investment capital allowance is increased from 5% to 15%;

(vi) Interest on loan on gas projects is to be tax deductible provided that prior approval was obtained from the Federal Ministry of Finance before taking the loan; and

(vii) All dividends distributed during the tax holiday shall not be taxed.

ANNEX 5: TAX RELIEF FOR INVESTMENT IN INFRASTRUCTURE

Incentives are granted to industries that provide facilities that ordinarily should have been provided by government. 20% of the cost of providing these infrastructural facilities, where they do not exist, is tax deductible. Facilities which fall under the scheme include access roads, pipe borne water and electricity.

ANNEX 6: TAX RELIEF FOR RESEARCH AND DEVELOPMENT

Industrial establishments are expected to engage in research and development (R&D) activities for the improvement of their processes and products. Tax relief is given for such projects. Up to 120% of expenses for R&D projects are tax deductible. Regarding expenses for R&D on local raw materials, up to 140% are tax deductible. Where the research is long-term, it will be regarded as a capital expenditure and will be written off against profit. Tax relief for R&D is given provided that such activities are carried out in Nigeria and are connected with the business from which income or profits are derived.

ANNEX 7: INCENTIVES TO THE AGRICULTURE SECTOR

Numerous incentives are given to stimulate investment in agricultural activities. These incentives include the following:

((i) Companies in the agro-allied business do not have their capital allowance restricted. It is granted in full i.e. 100%;

(ii) The payments of minimum tax by companies that make small or no profits at all do not apply to agro-allied businesses;

(iii) Agro-allied plants and equipment enjoy enhanced capital allowances of up to 50%;

(iv) Processing of agricultural produce is a pioneer industry, consequently there is 100% tax-free period for 5 years;

(v) All agricultural and agro-industrial machines and equipment enjoy 1% duty;

(vi) The Agricultural Credit Guarantee Scheme Fund (ACGSF), administered by the Central Bank of Nigeria, guarantees up to 75% for all loans granted by commercial banks for agricultural production and processing; and

(vii) The Interest Drawback Program Fund provides a 60% repayment of interest paid by those who borrow from banks under the ACGS, for the purpose of cassava production and processing. To qualify for these repayments, borrowers need to repay their loans on schedule.

ANNEX 8: INCENTIVES TO THE TOURISM SECTOR

Businesses operating in the tourism industry are entitled to the following benefits:

(i) The tourism sector was accorded preferred sector status in 1999. This makes the sector qualify for incentives (available to similar sectors of the economy) such as tax holidays, longer years of moratorium and import duty exemption on tourism related equipment;

(ii) Provision of basic infrastructure such as roads, water supply, electricity and communication facilities to the centre of attraction. Some states have allocated specific areas as tourism development zones thereby making acquisition of land easier;

(iii) Provision of land for tourism development at concessional rates; and

(iv) Availability of soft loans with long period of moratorium.

ANNEX 9: INCENTIVES FOR THE SOLID MINERALS SECTOR

The following incentives are available in the solid minerals sector:

(i) 3 to 5 years **tax holiday**;

(ii) **Low income tax** of between 20% and 30%;

(iii) **Deferred royalty payments** depending on the magnitude of the investment and the strategic nature of the project;

(iv) Possible **capitalization of expenditure** on exploration and surveys;

(v) **Extension of infrastructure** such as roads and electricity to mining sites;

(vi) The holder of a mining lease shall, where qualified, be entitled to:

- Depreciation or capital allowance of 75% of the certified true capital expenditure incurred in the year of investment and 50% in subsequent years.
- Investment allowance of 5%.
- Exemption from payment of customs and import duties.
- Expatriate quota and resident permit for approved expatriate personnel.

(v) In addition to roll-over relief under the capital gains tax (CGT), companies replacing their plants and machinery are to enjoy a once-and-for-all 95% capital allowance in the first year with 5% retention value until the assets is disposed, 15% will be granted for replacement of an asset.

ANNEX 10: INCENTIVES TO THE PETROLEUM INDUSTRY

A number of **investment incentives** have been introduced to further stimulate Nigeria's **petroleum industry**. The incentives in this sector are granted to companies that are in joint ventures with the Nigerian National Petroleum Corporation and have signed a Memorandum of Understanding. The following are Incentives to the petroleum industry:

(i) Guaranteed Minimum Margin of US$2.50 bl;

(ii) Accelerated capital allowances which provide that the capital allowances can be carried forward indefinitely;

(iii) Graduate royalty rates approved for oil companies;

(iv) Investment tax allowances (ITA) are granted to a company in respect of any asset for the accounting period. The ITA is graduated as follows:

- Onshore - 5%.
- Offshore in depth of up to 10m - 10%.
- Offshore in depth of between 100m and 200m - 15%.

- Offshore in depth of over 200m - 20%.

Pioneer status obtained by Companies during the year 2005

S/N	Name/Address of Company	Nature of Business	Type of Share Holding	Form M Value	Capital Importation (IN USD)	Equity/Level of Investment (in Naira)	Employment Generation	Sector
1	Jajef Limited No. 108B, Ojuelegba Road, P. O Box 6535, Srulere, Lagos	Manufacture of Plastic coated Steel Hangers	100% Nigerian	-	$ 77,830.20 and N3.8m	N10.0m	52	Manufacturing
2	Alconi Limited No. 116, Ogudu Ojota Road, Ogudu G.R.A, Lagos	Manufacture of Ethanol	Nigerian 55% Spanish 45%	$2,073,001.35 (or N235,285,654.35	-	N300.0m	37	Chemicals/Petro Chemicals
3	Mega Tech Engineering Limited No. 14C Durbin Katsina Road, P.O.Box 12178, Kano, Kano State	Installation of Telecommunication equipment and provision of fixed wireless telephony services	100% Nigerian	$426,162	-	N250.0m	41	Communication
4	Amioun Steel Limited No 7, Segun Irefin Street, off Ikotun Egbe Road, Egbe – Lagos State, P.O.Box 3382, Apapa, Lagos State	Manufacture of Iron and Steel products	Lebanese 70% British 30%	Euro 1,374,035.00	-	N10.0m	103	Manufacturing
5	Temp Paper Pulp & Packaging Limited, KM 5, Idiroko Road, Ota Ogun State & No. 56, Quarry Road, P.O.Box 2286, Abeokuta.	Manufacture of Paper Pulp, Kraft Liners, Paper Boards, Cartoons, Envelopes etc.	100% Nigerian	-	-	N10.0m	106	Manufacturing
6	MINL Limited No. 21/23 Abimbola Street, 1 solo industrial Estate, Isolo,	Smelting and refining of non-ferrous based metals and the manufacture	100% Indian	$12,100,000 @ N1,560,900,000.00	-	N725.0m	136	Manufacturing

-	Lagos.	of their alloys.						
7	*Benue Cement Company Gboko, Benue State	Cement Production	100% Nigerian	$120,000,000.00	-	-	-	Manufacturing
8.	Sara Foods Ltd 184/185 Happy Home Avenue Kirikiri Industrial Estate	Manufacture of Biscuits	Nigerian, Lebanese, Indian & Pakistani	Euro 2,449,272.00	-	N20 Million	218	Manufacturing
9	Persianas Properties Ltd	Real Estate Development	100% Nigerian	-	-	N135 Million	67	Construction
10	Sun 7 Sand Ind. Ltd Plot 1, Block XVI Ogun State Housing Corp., Ogun State	Manufacturing of Steel	Indian and Nigerians	$5,000,000.00	$99,985.00 @ 13,278,088.00	N50 Million	217	Manufacturing
11	Dana Pharmaceuticals Ltd, No. 54, marina Lagos	Pharmaceuticals	Indians, Nigerian and Britons	N169,600,000.00	$232,560.00.00 @ N20,000,160.00	N20 Million	550	Pharmaceuticals
12	Global Infrastructure Nig. Ltd Plot 3255, IBB Way, Maitama-Abuja	Manufacture of Iron and Steel	Indians	-	-	N10 Million	3,920	Manufacturing
13	Dangote Ind. Ltd, Marble House, Alfred Rewane Road, Falomo- Ikoyi	Manufacture of Cement	Nigerians	$204,391,508.41 Euro 533,075.07	-	N500 Million	150	Manufacturing

-	Lagos.	of their alloys.						
7	*Benue Cement Company Gboko, Benue State	Cement Production	100% Nigerian	$120,000,000.00	-	-	-	Manufacturing
8.	Sara Foods Ltd 184/185 Happy Home Avenue Kirikiri Industrial Estate	Manufacture of Biscuits	Nigerian, Lebanese, Indian & Pakistani	Euro 2,449,272.00	-	N20 Million	218	Manufacturing
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