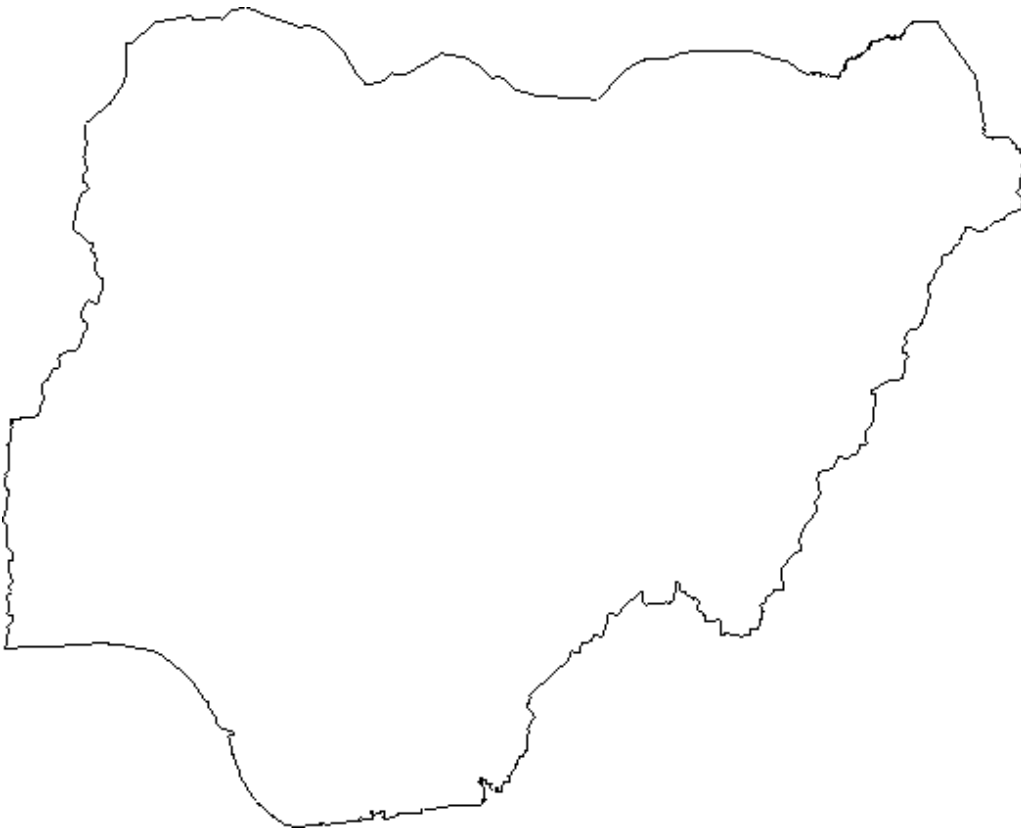


# A New Path for Nigeria



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Foreword by the Rt. Hon. Priti Patel MP

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## Foreword

### Nigeria: A Way Forward

#### The Rt Hon Priti Patel, MP, former Secretary of State for Development for International Development

Throughout history, sustained, job-creating growth has played the greatest role in lifting huge numbers of people out of grinding poverty. This is exactly what developing countries want and is what the international system needs to help deliver. But for too long development policy has been separated from trade and economic policy. Development policy must support free trade as one of the bedrocks of global prosperity and stability through focusing investment in job creation across manufacturing, infrastructure, energy and commercial agriculture to provide strong foundations for inclusive growth in the developing world.

This important paper focuses on these issues in Nigeria, a country with geo-economic, and geo-strategic importance on the African continent. Nigeria has also emerged recently from an election providing an opportunity for the re-elected Buhari government to show the world that it is able to move in the right direction. Nigeria is one of the largest recipients of Overseas Development Assistance provided by governments. It is eighth in the world, and second in Africa. This aid comes primarily from the US and the UK. However, as this paper notes, Nigeria is a laggard on many economic indicators and governance issues. Nigeria is one of the worst performers on governance in West Africa; it is the 4th most corrupt country in West Africa and 136th overall out of 176. Nigeria is the 2nd most fragile state in West Africa and 13th overall. In terms of transparency and accountability it ranks 85th out of 102 overall on the Open Budget Survey. In the World Bank's Ease of Doing Business Index it stands 146<sup>th</sup>. It trails on indexes of economic freedom such as Fraser at 118<sup>th</sup> and Heritage at 111<sup>th</sup> where it should be a leader in Africa.

Development must drive economic outcomes and be linked to the satisfaction of key economic and social indicators, such as whether the country is moving to a more open trading regime, towards genuinely competitive markets and better property rights protection, including intellectual property rights. Married to this are key fundamentals such as the rule of law and a good investment environment, which must not be eroded by government incompetence or corruption. This is because if we are to use our taxes to improve the lives of the poor around the world, then those taxes must lead to life changing outcomes and not be destroyed through bad policy choices and corruption in the recipient country.

In the US, the Millennium Challenge Corporation is one of the rare successes of development policy. Here money is granted for specific projects with a local Board empowered to ensure that they are finished on time and on budget, and critically the grant is conditional on the satisfaction of certain key benchmarks. These benchmarks are related to basic good governance ideas such as transparency and the rule of law. They are also related to the country's economic policy choices. If an MCC recipient starts to damage investors' rights or embarks on a trade policy that increases barriers, then its funding can be withdrawn.

The paper shows that troublingly, Nigeria is moving in a negative direction. More than 2 million Nigerians enter the job market every year looking for formal employment and Nigeria urgently needs more jobs and it needs better jobs. This is important both for the future prosperity of Nigeria but also for its long-term stability. In addition, Nigeria has poor health indicators including higher than average rates of under-five mortality and the highest number of maternal deaths in Sub-Saharan Africa. Despite Nigeria being Africa's largest economy with a population of 180 million and large reserves of oil and gas resources, 60 million live below the poverty line with another 60 million just above it and the average life expectancy is 52 years. This situation must and can change if Nigeria embraces open market reform and addresses many of the institutional and political failures that have hindered its own economic development.

Nigeria is a country rich in natural resources. In many ways this has proved to be both a blessing and a curse. In the oil and gas sector, we see a trade policy direction that is deeply troubling and heading progressively more and more towards local content regulation. The paper notes why the infant industry argument has been demonstrated to be an unsuccessful economic policy. Far from creating successful companies that are globally competitive, it creates companies that are less competitive and efficient and struggle in the face of global competition.

The increase of local content regulation and import substitution economics are concerning from a trade policy perspective. Perhaps most worryingly of all, the damage being done by a range of investor disputes where basic property and contractual rights are being violated seems to be on the increase. The erosion of Nigeria's commitment to the rule of law is highly worrying, both from a political and an economic perspective. The most notable disputes include with telecoms firm MTN; an energy project with P&ID; and a hydroelectric contract with Sunrise Power. In the P&ID case, the London tribunal found that Nigeria owed the company almost \$9bn, a significant percentage of Nigeria's foreign currency reserves. Resolving such disputes expeditiously will be essential to reassure both private investors and foreign aid donors.

From the perspective of the UK, we need to use every policy lever we have to ensure that Nigeria adopts a sustainable approach to economic development based upon transparency and an open trading and economic system that protects property rights and the rule of law. This involves development policy, as well as our own independent trade policy post Brexit. However - the main thrust of the necessary changes, as described in this paper, must come from Nigeria itself. The new Buhari government should now seize the opportunity.

## Executive Summary

Now that President Buhari has won the election in Nigeria, there are real opportunities to improve the Nigerian economy, attract new foreign investment to Nigeria, and signal a new direction for economic policy. These opportunities need to be urgently undertaken. There is always an opportunity at the beginning of the term of a new administration for creative ideas to take effect. We have laid out how this might be achieved and some key areas where Nigeria could make improvements.

These reforms and actions are not exhaustive – but focus on achievable policy actions that can be taken to improve the investment climate in Nigeria, improve opportunities for Nigerian entrepreneurs and consumers, and send a strong signal that the new government is committed to building a more open economy, based on the rule of law and sound policymaking.

Specific recommendations contained within the paper include the following:

- Nigeria must prepare for a coming shift in international development assistance: the UK is among several countries moving towards a U.S.-type Millennium Challenge Corporation (MCC) model based on rule of law and open investment climate
- Outstanding legal claims against the Nigerian government represent a significant risk factor for foreign investors: these cases should be settled early in the new government's term
- One case alone – the “P&ID” case – represents over 20% of Nigeria's foreign reserves and is a significant threat to investor confidence if not settled
- Local Content Rules (LCRs) harm Nigerian consumers and encourage corruption and cronyism: these should be removed wherever possible
- ECOWAS tariff schedules remain too high: Nigeria should work with its neighbours to reduce ECOWAS tariffs to benefit domestic consumption
- Nigeria should accede to the WTO's GPA Agreement, and adopt a more transparent approach to regulation and public procurement
- The use of Special Economic Zones should be encouraged as a mechanism for testing economic reforms at local level and boosting foreign direct investment
- Respect for the rule of law must be reinforced across Nigeria, starting at the highest levels of government, if corruption, a scourge on Nigeria's young democracy, is truly to be reduced

## 1. Macroeconomic Context

Nigeria's rankings in key indexes around the world that measure the quality of business environment, and general prosperity are poor. It ranks 146 in the World Bank's ease of doing business index (and is declining) out of 190 countries. It is ranked 129 out of 149 countries in the Legatum Institute's Prosperity Index. A country that should be one of the leaders in the African continent is instead ranked alongside the likes of Mali, Grenada and Zimbabwe. The fact that it ranks below Venezuela in the Prosperity Index is also telling.

Nigeria's debt to GDP level is 28%, quite good for a developing county. Most of the public debt (70%) is domestic. However, some worrying trends are evident for external debt. Since a Paris Club debt relief agreement in 2005 when Nigeria received an \$18bn relief package, the external debt has been increasing as of 2015. In fact, the external debt increased \$12bn in three years, going from \$10bn to \$22bn from 2015-2018.

However, many investors have ignored these recent trends as Nigeria has been able to raise \$8bn in Eurobonds in the last two years at rates that are very competitive compared to peers. In parallel, oil prices are relatively high, alternative investments in the international markets are paying very little, and the international macro environment seems stable.

## 2. Investment Context

Our experience is that investors significantly underplay the importance of micro-economic developments which ultimately drive the macro picture. In many cases, a single case, such as the Telmex WTO dispute settlement in the case of Mexico telecoms in the mid-1990s can have far reaching implications for investor confidence in a country. In that case institutional and other investors bet on Telmex, notably saying that the regulatory bias in Mexico favoured the incumbent. The reality was that there were significant regulatory restrictions in Mexico and trade barriers that stopped the foreign new entrants, such as MCI and AT&T (hardly small companies) from being competitive in that market. Telmex was able to do this by manipulating the domestic Mexican telecommunications rules so that the new entrants had to pay very high prices to interconnect into the Mexican network, and could engage in anti-competitive cross-subsidisation where it used the universal service fund to lower its costs in long distance and international telephony. These manipulations brought the government of Mexico into conflict with the (then) recently agreed rules of the World Trade Organisation's Basic Telecoms Agreement, as well as Telmex into conflict with Mexican competition law.

Investors did not consider that the regulatory barriers in Mexico could lead to a WTO case which Mexico lost, and led to vigorous antitrust enforcement by the Mexican Competition Commission that ultimately led to a set of rulings that disciplined the incumbent and lowered its profits. The Telmex case offers an example of why investors should consider regulatory and trade issues when making investment decisions.

In a case involving energy company, AES in Kazakhstan, AES signed contracts in which it invested over a billion dollars to upgrade Kazakhstan's rusty energy assets (owned by the state-owned electricity company, Samruk-Energy). When this work was largely finished, Samruk-Energy decided to violate the terms of the contract. AES was threatened by the Kazakh state with an antitrust case, in which it was accused of conspiring with itself. The conspiracy claim was important to Samruk-Energy because that it how AES officials could be threatened with a criminal case and prison. Kazakhstan was seeking to accede to the WTO at the same time, and this gave the US some leverage to secure better treatment. It is noteworthy that it is difficult to win such cases in legal courts or in arbitration (AES lost its case under ICSID arbitration in 2013), because often the government actions are hard to identify. However, they nevertheless create a hostile environment for investors and traders, and security of investment was threatened.

### 3. Development Assistance

Although large, Nigeria is still a developing country, and does benefit from substantial development assistance, as well as special treatment under the WTO's Special and Differential treatment provisions. Many countries are conforming their development policy to their own trade and commercial goals. The US has adopted the Millennium Challenge Corporation approach where countries must achieve benchmarks related to rule of law and good economic policies to qualify for grants. We can expect the UK, post-Brexit to adopt the same sort of approach, and many UK Foreign Secretaries and International Development Secretaries have said as much. In a joint report by Bob Seely, MP and the Henry Jackson Society, with a foreword by former Foreign Secretary, Boris Johnson it was noted that the UK's aid should be spent in line with Britain's diplomatic and commercial interests. Former International Development Secretary, Priti Patel, MP has noted that aid should be used to foster the nation's prosperity and to boost post Brexit trade. The current International Development Secretary, Penny Mordaunt, MP has said that aid should pivot to projects that can demonstrably show that the economic impact is positive. The reality is that this is the direction of travel of all the world's major donors, and development assistance will inevitably be tied to trade and commercial opportunities for all but the poorest countries. Nigeria, although by no means the poorest of countries received \$2.4bn in Official Development Assistance in 2015 (the eighth largest recipient that year) so this discussion is hugely relevant to Nigeria. It seems clear that if Nigeria is to continue to receive the levels of development assistance it has so far received, it will need to ensure that its legal, regulatory and business environment is conducive to investment flows and commercial activity.

#### 4. Terms of Aid

UK aid currently is not dependent on whether the recipient country is satisfying basic rule of law principles or compliance with international trade rules. This differs from the US's Millennium Challenge Corporation ("MCC"), where aid is conditioned on the recipient country adopting basic internationally mandated norms and standards. For reasons stated above, it is likely that UK development policy will start to take these considerations into account. This is because, if a country is violating basic trade policy norms and damaging the UK's access to its markets in the process, it makes no sense to try to give aid which will eventually be in the hands of the very producers who are benefiting from the barriers that damage UK producers and Nigerian consumers.

There are several long-standing trade barriers that Nigeria has enacted that damage the interests of its trading partner. The new government will go a long way towards sending a signal that it was open for business if it makes progress to lift these barriers. We have identified a handful of these barriers into broad categories.

#### 5. Rule of Law

The rule of law is a fundamental requirement for any stable society and a pre-requisite for economic growth. An independent, non-politicised judiciary and legally binding and enforceable contracts are a key part of ensuring the basic ground rules necessary to deliver a healthy and competitive economy. While there are many aspects of rule of law that are important such as access to justice, we will focus this paper on the underpinning legal institutions necessary to make an open and competitive market work to deliver real economic gains especially for the poorest in society.

Re-elected President Buhari made remarks last year suggesting that the rule of law should be subject to national security interests and must in general be subservient to the national interest. It is possible that President Buhari was concerned that some were confusing the rule of law with the rule of lawyers. However, these remarks are deeply pernicious because they suggest that the application of the rule of law and the national interest are somehow at odds. The reality is that the rule of law is the basis of a strong national interest. Indeed, without it, security concerns will increase rather than lessen because strong economic growth will be less likely. As recently as January 25<sup>th</sup>, and shortly before the election, the removal of the Supreme Court Chief Justice, Walter Onnoghen was a deeply troubling event striking at the heart of the rule of law. Even if the decision is reversed, the damage is already done as it illustrates the pressure that all judges must be under to affect the will of the government.

The global investment community regularly tests issues like rule of law. When countries renege on previously agreed contractual arrangements (as Nigeria has done in the P&ID case) or threaten the judiciary if their judgements go against the government or other groups privileged by government power, then global investors are given pause. In Nigeria many of



these things have been happening, and it is crucial for the new government to correct these issues and make a clean break from the past. The best way to do this is to honour existing contracts, and to demonstrate an impartial and independent judiciary by abiding by the decisions of the courts even where they are applied to the government, government officials, government instrumentalities or companies which benefit from government privileges, subsidy or other forms of aid.

## 6. Recommendations

These recommendations represent concrete actions that the new government can take, starting immediately, to enhance the rule of law, attract and encourage new investments, improve Nigeria's standing in the world, and position Nigeria competitively.

### i. Settling Outstanding Legal Cases

There are multiple outstanding judgments against Nigeria in the international courts that the new government should look to settle as soon as possible, to bring stability and certainty to the affected sectors of the economy; and to demonstrate that Nigeria is serious about upholding the rule of law.

It appeared that the Buhari government was seeking to deal with some of these cases, although no clear statements have been made since the election to re-affirm this approach.

A commitment to the rule of law requires fidelity not only to the legal institutions of the individual country, but also respect for the rule of law in other jurisdictions. It is common practice for contractual agreements in developing countries to stipulate a third-country venue for legal disputes or arbitration: London and New York are amongst the most popular, for reasons that are obvious. Past Nigerian governments have been prone to ignoring – or outright flouting – judgments made in the agreed external legal jurisdiction (most commonly London). The power of the negative signal this sends to future investors cannot be overstated.

Investors should think hard about the full implications of the trends in Nigeria with respect to property rights protection and what if anything might occur as a result of the large arbitration awards that exist today, and could be foreseen in future given the ongoing problems with rule of law and respect for rights of property and contract.

The four most significant ongoing disputes are with MTN – a South African telecoms conglomerate with major operations in Nigeria; P&ID – a BVI-domiciled firm that had a contract to supply natural gas to Nigeria; and the Esso-Shell-NNPC case; and Sunrise Power & Transmission Company / Sinohydro – relating to a contractual dispute over a hydropower project.

By far the most consequential is the P&ID dispute, in which a tribunal award in London has been awarded to the tune of \$8.9bn, or over 20% of Nigeria's foreign currency reserves. The case is a lesson for investors on how the abandonment of rule-of-law and respect for

contracts can lead to substantial risk. A High Court hearing scheduled for May 2019 could lead to P&ID seizing Nigerian assets in London to pay the award.

### Case Study 1: P&ID Contract and Tribunal Award

The case of Process and Industrial Developments (P&ID) is a prime case study of where past Nigerian governments have violated basic principles of rule of law, and thus have saddled Nigeria with substantial legal burdens that must be settled. P&ID is a BVI-incorporated sole-purpose engineering and project management company, founded by two Irishmen – Michael Quinn and Brendan Cahill – who had signed a major contract to build a gas processing facility in Nigeria.

#### The Project

The contractual agreement and dispute between Nigeria and P&ID over a Gas Supply and Processing Agreement (GSPA) has been ongoing since 2010. The terms of the original agreement allowed for a 20-year contract where P&ID would build a gas processing facility and Nigeria would supply the gas over that time and build a pipeline to carry the gas to the facility. The project would have refined “wet gas” into “lean gas” and allowed Nigeria to use the lean gas for industrialization and use in its electrical grid. The gas would have been processed and supplied to Nigeria at no cost, while P&ID would have sold the by-products (propane, butane and ethane) on the international markets. Under the agreement, P&ID had to transfer a 10% equity stake to the Nigerian Government. The project failed and entered arbitration.

#### Arbitration and Judgment

Arbitration proceedings commenced in August 2012, brought by P&ID. In accordance with the original GSPA, the arbitration proceedings were organised in London under the rules of the Nigerian Arbitration and Conciliation Act. During these proceedings, P&ID argued that the Nigerian government failed to construct the pipeline to supply the gas to the facility and secure a long-term gas supply agreement with producers. Because of this, P&ID claims the Nigerian Government defaulted on the agreement.

In June 2015, the Tribunal led by Lord Hoffman ruled in favour of P&ID, accepting that Nigeria had defaulted on the contractual agreement. The tribunal subsequently ordered Nigeria to pay P&ID \$6.6 billion in damages, plus interest - which has now risen to \$2.7 billion – a total of \$9.4 billion.

#### Current Developments

To date, Nigeria has refused to pay the judgement, and P&ID is currently litigating to enforce the award in U.S. federal courts and the High Court in London. In May 2019, the High Court is expected to make its decision on whether P&ID may commence the enforcement of the award.

## Scale of the Judgment

The P&ID – Nigeria contract dispute is an instructive example of the Nigerian Government’s approach to contract disputes. It is one of the largest awards ever issued against a sovereign, and yet the Nigerian government appears to have taken almost no steps to attempt a settlement or resolution. For a country that emerged from recession in 2016 and views international lending and investing as a key funding element for its record-high budget, the approach to such legal risks is alarming. The size of the award amounts to a significant portion of Nigeria’s foreign currency reserves and if left unresolved – and if enforcement is granted in London – could have a significant impact on the perception of Nigeria’s creditworthiness.

The repudiation of the initial gas contract (GSPA) is equally alarming. Developing governments, like Nigeria, will struggle to consistently attract investment and new trading partners, if they treat contracts as non-binding.

This poses a policy question for the U.K. A post-Brexit trade and investment policy will surely involve seeking partners that share commitment to the rule of law and sanctity of property rights and contracts. Nigeria’s suitability as a destination for investment, or enhanced trade relations, should be called into questions if the P&ID case, and others mentioned in this paper, continue to be ignored or dismissed by the Buhari government.

## Case Study 2: Esso-Shell-Nigerian National Petroleum Corporation

In this case, there was a dispute about who could lift how much oil from specific oil fields. The question was whether this dispute was arbitrable or whether it had to be decided by the Nigerian courts. The Nigerian courts had claimed the issue was a tax matter that was justiciable only in the Nigerian courts and could not be submitted to arbitration.

In the expert evidence given by retired supreme court judge Ogunlade, he notes the following (at specific paragraph numbers of his expert opinion):

- ¶ 52: While the treatment that Petitioners have received in the Nigerian courts is shocking, and contrary to Nigerian law, I understand that Petitioners are not alone in suffering such mistreatment. I am aware of three other disputes between international oil companies and the NNPC concerning NNPC’s overlifting of oil. I am aware that in all these disputes, the international oil companies have been awarded hundreds of millions, if not billions, of dollars in compensation from the NNPC. And I am further aware that none of these international oil companies have been permitted by the Nigerian courts to recover any amount of these awards. In my opinion, the decisions of the Nigerian courts in these other disputes are similarly flawed in their holdings, and all constitute cases of extreme results-oriented decision-making.
- ¶ 53: For example, I am aware that in a case seeking to enforce an arbitral award (for several billion dollars in damages) against the NNPC in respect of essentially the same breaches as those at issue here, the Court of Appeal set aside the award, *inter alia*, on grounds that the pleading initiating the arbitration was not signed, individually, by an

attorney admitted to practice in Nigeria, but was instead signed in the name of both an international and a Nigerian law firm. This holding was said to be justified by reference to the rules applicable in relation to local court filings. Yet it was directly contrary to what other Nigerian courts have found: that there is no requirement for a notice of arbitration to be signed by an attorney.

- ¶ 54: In my opinion, this is another example of the courts reaching out to apply inapplicable legal principles to bar recovery on significant damages awards against the NNPC. As I have observed previously, the only rules applicable in arbitrations pursuant to Nigerian law are those stated in the ACA and the Arbitration Rules appended to them (in addition to any other arbitration rules agreed upon by the parties to the arbitration in their arbitration agreement). Indeed, Nigerian courts have recognized that arbitration is in part defined by its “informal settings and flexible principles” and not the “legal principles that bind a Court of law.”<sup>10</sup> There is therefore no occasion for the courts to seek to apply court rules of pleading to an arbitration, and no basis for an award to be set aside on grounds that court rules of pleading were not complied with. I can see no basis in Nigerian law for applying the pleading requirements applicable to Nigerian court proceedings to arbitrations in Nigeria.

These are damning statements from a retired Supreme Court judge on how the Nigerian courts have essentially conspired to protect the interest of the state company over the interests of the foreign entrants to the market. If investors (both foreign and domestic) cannot rely on the courts for impartial and unbiased judgment, the rule of law has indeed broken down.

## ii. Reform of Local Content Rules

Nigeria has tended to rely on the use of local content rules to promote its domestic production. It has also used these rules to promote self-sufficiency. The problem is that these rules are anti-competitive market distortions which damage the domestic economy, make products more expensive for consumers and harm foreign exporters and investors. There have been variants of these economic development ideas which are well meaning but have unintended consequences. One variant of this was the so-called infant industry argument. The idea was that governments could invest in protected domestic industries which would then be able to compete against global competitors when they were ready. The problem with this argument is that the infants never really grow up, and so remain uncompetitive vis à vis other global firms. When they are eventually exposed to global competition, they lose out. It is the heat of competition that makes firms more likely to compete with other firms effectively.

## Economic Analysis of Local Content Rules, Self-Sufficiency and Infant Industries Arguments

A common case for protectionism is the ‘infant industry argument’. The idea is that profitable industries that might increase overall welfare don’t develop in a country due to foreign competition. Because new firms will not immediately be able to produce at a competitive price, as they need to train their workforce or gain necessary experience, established foreign firms will force them out of business, preventing a local industry from developing. This argument has been used historically to justify temporary (in theory) protective tariffs for new industries.

The argument however has been strongly criticised. The most obvious critique is that where an industry will be profitable in the long run, it should be able to attract investment to tide it through an initial period of low returns. But even where there might be a failure of the market to provide such investment, it is still not clear that tariffs are the best solution. The problem faced by infant industries is often a ‘free rider’ problem, where investment in product development or market research also benefits potential competitors (often other local firms). This means firms are deterred from making the necessary investments to develop the industry. In this case, direct support for research or improved protection of intellectual property would be better alternatives.

Another version of the ‘infant industry’ argument is that too few new industries are created in general. This is normally blamed on excessive risk aversion among either investors or potential entrants. As such, proponents argue that higher prices resulting from protectionism are needed initially in order to encourage new industries. This is also highly contentious. Firstly, many new industries appear without benefitting from government intervention, so it is not obvious that this sort of systematic overestimation of risk occurs. Secondly, it is still not clear why tariffs are the solution. Once again, direct relief - in the form of a tax break as opposed to a fund - to small businesses would be a more appropriate response to a widespread aversion to investing in or creating start-up industries. More importantly, these companies will ultimately face global competition and will not be able to succeed in the global marketplace if they have developed inefficiencies because they have been sheltered behind a tariff wall.

More recently however, ‘infant industry’ arguments have been used to justify non-tariff forms of protectionism (in keeping with the global trend towards lower tariffs and higher non-tariff barriers). An example here would be local content restrictions (LCRs), common both in developing and developed countries (where they are often used to stimulate the Renewable Sector). Under these, goods need to meet certain content requirements to be eligible for government procurement or otherwise receive public support.

However, LCRs tend to fall foul of the same issues beleaguering tariff protectionism. Namely that they are an indirect solution to a problem which, where it persists, will be more effectively solved by direct support. There is also increasing evidence of the damage done by LCRs in reducing trade. According to a recent estimate, LCRs affect 5% of global trade, and cause estimated losses in the region of \$93bn per annum. This may well be an underestimate due to the difficulty of quantifying the impact of LCRs, as well as those that aren’t identified

in surveys. Added to this should be further concerns about the resources diverted to meet LCRs, which might otherwise have been more productively used.

Like tariffs, LCRs still require those creating them to ‘beat the market’, by efficiently choosing the correct industries to which to grant protection. If investors are getting these decisions wrong, it is not clear why politicians should get them right. Failure here would lead to the support of industries that could never succeed. The industries benefitting from LCRs would never reach a position where they could survive independently, and so would remain permanently dependent on the government for survival. This problem may even be exacerbated by unnecessary protection granted to firms that otherwise would be competitive. Industries may be encouraged to depend on government support rather than on the inward investment and innovation that such protection was intended to foster. LCRs are very distortive of ordinary market competition for these reasons and tend to cause some firms which are smaller and less able to satisfy them to exit the market.

Finally, decisions surrounding LCRs are likely to be subject to ‘political economies.’ This is where politicians make decisions based on their own interests, not those of society at large. This might lead to the introduction of LCRs based off cronyism or in return for votes, rather than on sound economic grounds. It also means that such protections would be very difficult to remove. Members of protected industries have historically been deeply reluctant to see protection withdrawn and are prepared to lobby as such. The result could be a policy of pure protectionism for certain industries, which harms consumers domestically and encourages retaliatory moves abroad. This approach, unfortunately, has a long and inglorious history in Nigeria and remains a significant risk factor for the economy despite President Buhari’s repeated promises to root out corruption.

#### Local content restrictions in oil and gas

The oil and gas sector is another critically important sector for the Nigerian economy. Local content restrictions in this area are intended to build up a domestic support industry which will generate more Nigerian jobs and build a business base. The problem is that particularly in this sector, it is very important to allow foreign investment and trade as the necessary global expertise is in short supply domestically. Local content restrictions are an anti-competitive market distortion, which destroys wealth out of an economy and pushes the people of the country deeper into poverty.

#### Local content rules in telecommunications

As in many other sectors, there are several local content rules in the telecoms sector. These are particularly problematic in this sector, because key innovations depend on having a vibrant communications sector. Firms that have specific technologies will feel disinclined to invest and will seek other markets. The result will be a slowdown in the take up of vital new technologies with ramifications across all sectors. In the telecoms sector, MTN as a foreign entrant has faced constant changes in its contracts, tax status and the regulatory environment

as the incumbent is constantly protected. MTN's problems mirror those of the new entrants in the Mexican market in the 1990s which we described earlier.

iii. Market Access and Tariff Schedules

There are many trade areas where improvements can be made, and any changes announced by the Buhari government would send important and positive signals to the investment and business community.

Improve Market Access for Meat Products

Currently Nigeria maintains extensive bans on meat products and uses its SPS regime to block access from its trading partners. This has been a subject of concern for many of Nigeria's trading partners for some time. An early indication that Nigeria would be prepared to be more open in trade terms would be a step in the right direction. Opening Nigeria's market for meat products would be good for Nigeria's consumers as they would be able to have greater choice and have lower prices.

Tariff Schedules

Nigeria is in a Customs Union with other West African countries, the Economic Community of West African States ("ECOWAS"). The ECOWAS CET is very high in certain sectors. Nigeria is potentially a powerful force within ECOWAS to lower tariffs to the outside world. Many countries have lowered intermediate goods tariffs for example (Canada has eliminated its intermediate goods tariff to make its manufacturing sector more competitive). The ECOWAS CET is very high for intermediate goods (10%). Some products face very high tariffs to protect domestic markets such as cars (35%). Lowering these tariffs could give Nigerian consumers access to more choice and lower prices. If Nigeria were to work within ECOWAS to reform the CET or to encourage members to apply a lower tariff, this would be seen to be a very positive step.

Major issue with customs and port practices (licence for corruption)

Customs processes in Nigerian ports have clearly been choke-points for increased corruption. It is critical that the WTO Trade Facilitation Agreement is fully complied with. Any improvement in port processes will be quickly picked up by traders and this will improve Nigeria's performance on major indicators like the World Bank's Doing Business Index.

iv. Accession to the WTO GPA

If Nigeria were to accede to the WTO GPA agreement, then this would send a very strong signal to the global community that Nigeria was seeking to adopt a more transparent approach to regulation and public procurement. This would increase the likelihood of Nigeria increasing trade and investment flows. It would also be an indication of good governance and should make Nigeria more likely to receive donor funds, as well as appear a more friendly place for investment and trade.

#### Eliminate local content margin of preference for GPA

Much Nigerian government procurement has local content rules which are difficult for foreign suppliers to satisfy. This damages trade flows with the country. Elimination of these will have a very positive effect on the investment and trade climate.

#### v. Use Special Economic Zones (benefiting from federal nature of Nigeria).

Nigeria could combine the need for reform of the ports and its customs and trade facilitation regime by agreeing to lower tariffs, and by allowing Free Trade Zones to appear. These special zones require entities in them to satisfy the rules of the zone, but not other rules pertaining outside it. This can be required for trade or as a pathway to bring together support for the re-elected President Buhari's ultimate economic plan.

These zones would have the support of many countries as they could provide alternative delivery mechanisms for reform. They would also act as demonstration models for ports in the country. The Special Zones could be used to test reforms such as limiting local content rules and ensuring a better regulatory framework.

#### Restrictions on capital flows

Restrictions on capital flows such as those maintained by Nigeria are a considerable problem for investors who seek to ensure that they can repatriate capital. Restrictions make investors more wary of the location as a potential investment opportunity.

#### vi. Costs of Corruption

It is impossible to discuss rule of law and the future of Nigeria without a serious discussion about the costs of corruption.

Precise estimates of the cost of corruption can be hard to come by, but the absolute costs of corruption appear to be significant. The World Economic Forum has stated these costs to be in the region of 5% of global GDP. In specific regions they may be even higher. The African Union in 2002 estimated that African countries were losing 25% of their GDP each year to



corruption. A recent PWC study also found a strong negative association between perceived corruption and GDP per capita.

Whatever the precise figures, corruption does significant damage, particularly to developing economies. This is because corruption increases the costs of doing business and encourages the inefficient allocation of resources. Furthermore, high levels of corruption will often disproportionately harm the least well off in society and can lead to a breakdown of trust and legitimacy. This may further result in damaging political instability (as witnessed in the Arab Spring for instance).

Corruption increases the costs of doing business in several ways. Firstly, a bribe is often an additional transaction cost (“the price of doing business”), which will decrease the number of worthwhile transactions that occur. Global bribery has been estimated to be as much as \$1 trillion per year. Secondly, the risk of prosecution, and the danger of missing out on contracts due to corruption, creates significant uncertainty for businesses. This also raises costs, as businesses need to hedge against these risks, which can often mean engaging in further corruption.

In the second place, corruption leads to the inefficient allocation of resources. This can occur through simple embezzlement, but also when businesses simply choose not to enter a country or sector due to raised costs and increased uncertainty. This effect can be observed in investment, where the IMF has found a 5% decrease in investment relative to countries that are relatively corruption free. This means that investment instead flows to countries or sectors where it could be less well used.

This effect can also lead to overinvestment. For instance, governments may wrongly direct investment into certain sectors and companies as a result of corruption. In both cases the result is a misuse of resources, leading to lost output. As with subsidies, such cronyism often creates a constituency for its own continuation and can be incredibly difficult to stamp out. Nigeria is one of the world’s most glaring examples of such a cronyist trap: when former UK Prime Minister David Cameron claimed that Nigeria was “fantastically corrupt”, President Buhari wearily accepted that this was in fact accurate.

Within companies, nepotism can also lead to inefficient hires of friends and relatives over superior candidates. The result is that the services provided are of an inferior quality, harming those forced to rely upon them. In the case of government corruption, this is often the poorest in society who are unable to access better alternatives, and who lack the privileged access to political power brokers.

Finally, corruption creates perverse incentives for bureaucracies. The longer and more bureaucratic a process, the greater the opportunity for corruption in allowing those who can afford to do so to bypass the system. This is particularly pernicious in its impact on the poorest, as they are unable to afford the bribes needed to obtain the superior service.

The net result of these effects is that corruption in public office allows for the politically connected to enrich themselves at the expense of the least well off, while making the whole

of society poorer due to the poor business environment and the misuse of resources. As such, we should not be surprised by political unrest in countries where the legitimacy of the state has been undermined by such practices. Sadly, such instability is often a deterrent for businesses looking to invest and so contributes further to lost investment and economic activity.

## 8. Conclusion

The re-election of President Buhari allows Nigeria to take immediate steps to demonstrate that they are seriously considering how to improve their economy and make it more friendly to investors and traders. We have indicated in this paper some of the steps which the Nigerian government could take which would immediately have a positive impact.

We have highlighted the landmark legal case of P&ID - which covers forty per cent of Nigeria's foreign reserves - and where there is a pending enforcement action which the Nigerian government could immediately resolve. Such an action would reverberate around the business and investor communities, sending a signal that the new Buhari government is serious about its international responsibilities, and a commitment to the rule of law.

Reversing damaging policies which stem from an import substitution approach would also be important, as well as other trade-related steps including accession to the WTO GPA and revising tariff schedules in ECOWAS.

The election result presents Nigeria with an opportunity to show the world that it intends to address many of the micro-economic issues which have held back its development. If Nigeria takes at least some of the steps outlined in this paper, it will go some way to being more of the leader in Africa that its size and population suggests it should be.