



Trade Policies, Exchange Rate and Developing Country's Real Sector Export Performance

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ABSTRACT

For developing countries like Nigeria, empirical evidence have shown they are faced with policy management challenge because they are mostly involved in the production and export of primary products which is often characterized by unfavorable terms of trade. The essence of this study therefore is to ascertain if trade and exchange rate policies complement each other in stimulating non-oil exports, especially the agricultural and manufacturing sectors, using both aggregated and disaggregated approach. Empirical results suggest that the various exchange rate regimes in Nigeria have not produced the desired result that accentuates export performance. Results reveal that imported input and real world income promote export performance of the entire real sector, while terms of trade has insignificant impact. The sub-sectoral analysis of reveals that exchange rate regimes over the years have neither produced the desired results of enhancing agricultural exports nor manufactured exports. This suggests that exchange rate policy has discouraged manufactured exports because its production highly depends on imported inputs. The policy implication of the above findings is that there is need to achieve an equilibrium exchange rate that when combined with export incentives will promote non-oil exports in Nigeria.

Keywords: Trade, Exchange Rate, Manufacturing Sector, Agricultural Sector

JEL Classifications: C22, E22, F13, F31, O14, O24

1. INTRODUCTION

The role of international trade in accentuating economic growth has been acknowledged in development literature. Adewuyi and Adeoye (2005) assert that such provides opportunities to expand productive activities. Through imports, domestic absorption is expanded, while export enables economic agents in a country to earn foreign exchange needed to embark on various economic activities. In doing this however, a country needs to maintain, at least, equilibrium between import and export so as not to experience deficit in payments balance. In this regard, for any country to benefit from trade, there is need to put in place appropriate trade and exchange rate policy that will promote trade, especially export, so as to ensure that import do not grow beyond export.

For developing countries like Nigeria, empirical evidence have shown they are faced with policy management challenge because

they are mostly involved in the production and export of primary products which is often characterized by unfavorable terms of trade (Adewuyi and Adeoye, 2005). And inspite of series of government efforts, the growth performance of Nigeria's non-oil export has been rather slow and erratic. For instance, from 1960 to 1990, non-oil exports grew at an average of 2.3% while its share of total export declined from about 6.0% in 1960 to about 3.0% in 1990 (Ogun, 2004). On the sectoral contribution to non-oil export, between 1980 and 1985, agricultural sector contributed about 4.0% and 67.0% to total export and non-oil export respectively. Meanwhile, the shares of manufacturing sector in these categories of exports are about 1.0% and 13.0% respectively during this same period. The dominance of agricultural sector in economic activities during this period was reflected in its share of aggregate output of the economy, which was about 30%, while that of manufacturing was <7%. Meanwhile, in terms of export, the performance of the sector has not been encouraging. This poor export performance can be seen in their average growth rates which declined by about

2.6% and 12.5% respectively between 1980 and 1999. In 1970, non-oil exports as proportion of total export was 42.4% but fell drastically to 6.2% in 1989 and increased to 8.5% in 2008. Annual average total export fell from 10.6% in the control period of 1970-1985 to 3.3% in the 1986-2011 pro-deregulation eras.

Even though non-oil exports according to the Bureau of Statistics Trade Report (2012) increased from 8.5% in 2008 to 30.8% in 2012, the performance and contribution of the non-oil exports sector compared to the oil export is still very low. As stated by WTO (2011), agricultural production has been increasing steadily for several years as it has benefited from better prices, a more stable policy environment and the revaluation of the Naira, it is still operating well below potential. As enunciated by Adewusi and Adeoye (2005), eventhough the contribution of these sectors to non-oil sector remained significant, their share to total export has declined over the years. Even though the economy is relatively opened, the overvalued exchange rate might have affected non-oil export performance. There is therefore the need to ascertain if these policies complement each other in stimulating non-oil exports, especially the agricultural and manufacturing sectors, using both aggregated and disaggregated approach. Most of the studies conducted in this area are inconclusive and aggregative.

Over the years, Nigeria has employed various trade policy instruments such as tariff, import restrictions and outright ban of some imported commodities. During the 1970s and 1980s, increased export earnings coupled with the highly over valued naira exchange rate made it possible for Nigeria to finance huge food imports and consequently help to depress domestic prices. In the 2003-2009 period, tariffs was the main trade policy instrument as Nigeria been aligning its tariff with the ECOWAS common external tariff. As a result, the average applied MFN tariff decline from 29% in 2003 to 12% in 2009. However, the average bound tariff was 11.8% in 2009 and only 20% of tariff lines are bound. The significance difference between the average applied MFN tariff rates and the average bound rates and the low coverage of bindings made tariff quite unpredictable and acts as a significant disincentive to non-oil export (WTO, 2011). In addition, 11 export processing zones were established with more being overseen by the Nigerian Export Processing Zone Authority.

The evolution of the foreign exchange market in Nigeria has been influenced by a number of factors such as the changing pattern of international trade, institutional changes in the economy and structural shifts in production (CBN, 2016). Exchange rate arrangements have undergone significant changes over the past four decade. With the establishment of Central Bank of Nigeria (CBN) and the subsequent centralization of foreign exchange authority in the bank, the need to develop a foreign exchange market became imperative. In the early 1970s, following increased export of crude oil, foreign exchange receipts was enhanced. During this period, there was a boom in foreign exchange market and the management of foreign exchange resources became necessary to ensure that shortage did not arise. However, it was until 1982 that comprehensive exchange controls were applied due to foreign exchange crises that set in that year. The increasing demand for foreign exchange at a time when the supply was declining encouraged the development of a flourishing parallel

market for foreign exchange. In 1989, Bureaux de Change was licensed to give access to small users of foreign exchange and officially recognized foreign exchange market. As a result of volatility in rates, further reforms were introduced in the foreign exchange market in 1994. These included the formal pegging of the naira exchange rate, the centralized of foreign of foreign exchange in the CBN, the restriction of Bureaux de Change to buy foreign exchange as agents of CBN, the reaffirmation of the illegality of the parallel market and the discontinuation of open accounts and bills for collection as means of payments sectors (CBN, 2015). The foreign exchange market was liberalized in 1995 with the introduction of an Autonomous Foreign Exchange Market (AFEM) and it was further liberalized in October 1999, with the introduction of an Inter-bank Foreign Exchange Market (IFEM) was introduced in 1999 to diversify the supply of foreign exchange in the economy by encouraging the funding of the inter-bank operations from privately-owned foreign exchange and assisting the naira to achieve a realistic exchange rate. Just like AFEM, the operation of IFEM experienced setbacks which led to the introduction of the Dutch Auction System (DAS) in July 2002. The DAS was designed to achieve a realistic exchange rate of the naira that will stem the excess demand for foreign exchange and conserve the dwindling excess reserve. Since its inception, this system has largely been successful in achieving its mandate because it has assisted in narrowing the arbitrage premium from double digit to single digit, until the emergence of irrational market exuberance in the fourth quarter of 2003. DAS also enhanced the relative stability of the naira in relation to US dollar. Since the exchange control era, a parallel market has been in existence. It has been established that scarcity in the official sector and bureaucratic procedures necessitated the growth and development of the parallel market.

2. REVIEW OF PREVIOUS STUDIES

It has been argued that in most developing economies, trade policy measures have not been effective in restoring equilibrium in balance of payments. This is based on the fact that export subsidies introduced by a country to boost export in an attempt to correct deficits, may be quickly emulated by other countries. To this end, Bergstern (1977) asserts that the import surcharges and deposit schemes adopted by most countries usually deepen their existing disequilibrium because such has added to the inflationary pressure in most countries experiencing deficits and their attempt to raise import prices, and hence reduce the volume of imports was frequently offset by price cuts or the extension of credits by foreign suppliers who perceive the measures as temporary and hence, were willing to shelve profit motive in order to maintain market position. The role of non-oil exports, particularly manufactured exports, in macroeconomic adjustment has also been stressed. It has been argued by Rajapatirana (1995), Liu (2007), Giles and Williams (2000) and Bourdet (2002) that an expansion in manufactured exports removes the constraints on foreign exchange, provides more confidence for policy makers to sustain trade reforms and gives room for lobby that would support complete trade reforms. In essence, Sahni (2012) opine that in the East Asian countries, manufactured exports played a significant role in sustaining macroeconomic adjustment and in laying foundation for increased output growth.

Exchange rate changes could produce positive results on exports and output growth. It has been argued that depreciation of currency either through a gradual downward exchange rate floating or through an instantaneous outright devaluation of currency should among other desirable effects, promote domestic output and exports particularly, the non-oil exports (Chete, 1995; Oyejide and Ogun, 1995; Obadan, 1998). These favorable effects would be achieved through devaluation that makes exports more attractive and the resulting expansion in demand for exports will lead to an expansion in the level of export production in order to satisfy the growing demand and this will consequently lead to a growth in domestic output. This will have multiplier effects on investment, income, employment and spending in both the export and non-export sectors of the economy (Ubok-Udorm, 1999; Obaseki and Bello, 1996). However, the export - and output - enhancing effect of currency depreciation or devaluation is not completely guaranteed because devaluation may have contractionary effects depending on the elasticities of import demand and export supply (Ubok-Udorm, 1999; Ekpo, 1993). Devaluation or currency depreciation will lead to an increase in the cost of production of exports particularly when the production of exports heavily depends on imported inputs. This could escalate the inflation rate with serious consequences for macroeconomic performance (Komolafe, 1996; EBRD, 2013).

In order to quantify the importance trade policies and the impact of exchange rate in a subgroup of emerging markets economies committed to improve non-oil exports, Shahbaz (2012), used cointegration, causality and forecast error variance decomposition framework for Pakistan. Sen and Chinkunda (2002), Virmani. (2003) and Sirmani (2004) find that developing countries, exchange rate that translates into changes in import prices and hence consumer price reduces the citizens welfare. They rationalize this in two ways: (i) for such economies, high inflation in the past has induced widespread wage and price indexation. In this case, changes in consumer price index as result of fluctuations in exchange rate are fully and automatically locked in future wage and price inflation., (ii) As a result of non credibility of Central Banks policies in developing countries, a temporary shock in the exchange rate that will be accommodated may become permanent and these shocks indeed affect inflation permanently through lagged effects. Perhaps, one of the notable early studies in Nigeria in this area include Ajakaiye (1987), who find that among developing countries, Nigeria exhibits the highest inflation and exchange rate variability and average non-oil export growth is lower. In essence, Nigeria seems to face a macroeconomic environment that is more volatile than Brazil, Chile, South Africa, at least in terms of inflation and exchange rates (Ajakaiye and Soyibo 1995). Ayodele (1997) emphasized on the relationship between floating exchange rate engendered by naira exchange rate adjustment and non-oil exports of Nigeria, adopting aggregated approach. Employing the gravity model, a notable finding of the study is that the incomes from Nigeria's major importers like Britain, Germany, the United States of America and France are negatively related to non-oil exports. This may be attributed to the nature of the demand for primary products which have many substitutes. There is therefore high tendency for the advanced industrialized countries to develop better technologies for less

use of these primary products even when their incomes are rising. It was also found that, for some importers of Nigeria's non-oil exports such as Britain and Germany, real exchange rate (RER) has a negative impact on non-oil exports, while for France and USA, the impact is positive. These outcomes may be associated with the varying reactions of different countries to the variations in the Nigeria's exchange rate especially when exports consist of primary agricultural products while RER elasticities are low for Nigeria's non-oil exports. With respect to the degree of diversification, Ayodele (1997) reports that the diversification ratios in respect of oil and non-oil exports rose over time rather than decreasing. Due to the structure of Nigeria's non-oil exports coupled with the demand elasticities, the floating exchange rate regime has not achieved the objective of promoting non-oil exports and diversifying the export base in Nigeria.

Komolafe (1996) employed a non-oil export supply function and an import demand function to examine the extent to which exports and imports respond to exchange rate adjustments in Nigeria. Adopting co-integration and error-correction model, the estimated results show that foreign sector has been significantly responsive to the exchange rate adjustment both in the short and long-run. This finding is most likely to surround these empirical findings because it is evident from all indications that in spite of the various intensive reforms, the Nigerian economy has not adjusted. Neither the composition of exports has been diversified nor the imports been fully liberalized to evolve domestic import substitutes needed to complement the non-competitive imports with a view to conserving the foreign exchange reserves. Ajakaiye (1994) investigates the impacts of exchange rate depreciation on sectoral prices over 1986-89 period, using a version of the input-output price model in an economy where prices are determined primarily on the basis of full mark-ups on costs. The findings shows that the continuous depreciation of the naira exchange rate contributed to continuous rise in sectoral prices, stating further that this contributions seems to be greater in the short-run than in the medium term because other policies such as those on petroleum prices review, interest rate on loans and prices of imported inputs that triggered upward movement of prices were executed. The study also found that all sectoral prices rose because of the effects of exchange rate depreciation on the structure of prices, although the increases in prices vary across sectors such that exchange rate depreciation can induce relative price changes.

In determining the impact of RER on growth of non-oil export in Nigeria, Ogun (2004) specifically analyzed the effects of RER misalignment and volatility on the growth of non-oil exports with the aid of the standard trade theory model of determinants of export growth and two different measures of RER misalignment. One of the models entails deviations of the purchasing power parity while the other model based on estimation of equilibrium RER. The study reports that, irrespective of the alternative measures of misalignment adopted, both RER misalignment and volatility adversely affected growth of non-oil export. From the foregoing, it is obvious that studies have not consider the impact of trade and exchange rate on sectoral exports. While some were restricted to the assessment of the impact of exchange rate depreciation on sectoral prices, others considered issues such as the impacts of

trade and exchange rate policy changes on non-oil exports. It can also be seen that most studies on Nigeria has been done at the aggregate level. This therefore informs this paper which employs a disaggregated approach that could provide more insights into the issue of non-oil export performance in Nigeria.

3. METHODOLOGY

The data for this study were generated mainly from secondary sources. These sources include both local and international sources which include CBN, World Bank Development Indicators and the International Financial Statistics. Data covered the period, 1980-2014. This study focuses on the manufacturing and agricultural sectors. The choice of these two sectors is informed by the fact that they are major part of the real sector that actively and regularly involved in international trade, in terms of export and import. This therefore makes activities in these sectors susceptible to the influences of domestic trade policy. Although in Nigeria the petroleum sector dominates the economy, agriculture is more important to most Nigerians as it represent over half of employment. Variables of interest are real sector export performance (RSexp) proxied by manufactured or agricultural exports, imported inputs (IPI), proxied by value of imported capital goods and raw materials as a ratio of gross domestic product, RER, merchandise terms of trade (TTR) which is the relative price of export and import, total welfare (TWR).

The methodological framework adopted by this study is the standard trade model of export determinants propounded by Ogun (2004). The conventional multiplicative export demand function with constant elasticities can be specified as follows:

$$\text{Exp} = \varphi (Y_{\alpha}/T^*e)^{\beta} (W)^{\varepsilon} \quad (1)$$

Where, φ is a constant, β is the price elasticity of demand for exports and W is the level of real income, while ε is the income elasticity of demand for export. Y , α and T are the domestic price of exports and foreign price of imports respectively, e is the exchange rate which is the domestic price of foreign currency. Log-linearising the above function gives;

$$\text{LogExp} = \varphi_0 + b_1 \log Y + b_2 \log T + b_3 \log W + e \quad (2)$$

In line with the variables considered by this study and on the premise that production activities in a developing country heavily depend on imported inputs, equation (2) is augmented with an import as follows:

$$\text{RSexp} = a + b\text{IPI} + b_1 \text{RER} + c\text{TTR} + d\text{TWR} + e\text{IMP} \quad (3)$$

In its logarithm form, the above relationship can be stated as:

$$\text{LogRSexp} = a + b\log\text{IPI} + b_1 \log(\text{RER}) + c\log\text{TTR} + d\log\text{TWR} + e\log\text{IMP} \quad (4)$$

As long as none of the assumptions guiding the ordinary least square (OLS) is violated, OLS remains the best unbiased linear estimator. In both models, there is no reason to suspect that OLS

assumptions will be violated, which in turn could lead to bias estimates using OLS. A prominent assumption of the OLS whose violation often causes bias in estimates is the assumption that the expected value between the regressors and the error term should be zero. In other words, there should not be any correlation between the regressors and the error term. In our specified model, none of the included core variables that measure real sector performance is endogenous; they are all exogenous or determined outside the specified model. Also, other relevant variables that explain the outcome or dependent variables apart from the core variables will also be captured as control variables. This will help to prevent any correlation between the regressors and the error term, which in turn will ensure OLS estimates are unbiased.

Models were estimated using Stata software. Where and when necessary, Eviews, another related econometrics software, was used to complement the Stata software. Similarly, both software were used to for all data transformation and descriptive statistics.

4. RESULT AND DISCUSSION

The summary statistics of the variables used in the model was first conducted to determine their behavior. This description of data will provide a first insight into the nature of the variables used, before any empirical estimation is carried out. Thus, this sub-section provides some general description of the data used in this study. The description provided is the mean of the variables used. Also provided are the median, standard deviations, maximum and minimum value of the variables. The results of the summary statistics are presented in Table 1.

From the result presented in Table 1, IPI averaged 338864 with a standard deviation of 5213418 within the periods under study. The average RER within the periods under study stands at 65.9 with a standard deviation of 48.8. With respect to TTR, the average figure stands at 156.1 in Nigeria per year with a standard deviation of 156.1. The average imports stands at 0.9 within the periods under investigation and the standard deviation of that value is 1.23.

4.1. Unit Root Test

Since time series are used for analysis, it is important to examine whether they has unit root, that is, whether they are stationary at level form or not. The essence is to avoid estimates that are spurious. The widely used augmented Dickey–Fuller (ADF) test of unit root is employed in this study to check whether our data are stationary or not. The results of the ADF tests are presented in Table 2, first for the whole economy, followed by that of each of the sector. The decision rule is to reject the null hypothesis of non-stationarity if the ADF test statistics in greater than the critical value in absolute terms. We do not reject otherwise. The test statistics are evaluated at the 5% critical value.

As can be observed in Table 2, the test of stationarity results reveal that all other variables have no unit root (stationary at level). This implies that they became stationary after first difference or integrated at order one at 5% critical value.

Table 1: Summary statistics

Variable	IPI	RER	TTR	TWR	IMP	AGO	MAO
Mean	3,888,864	65.9	156.1	241,878.5	0.9	-3.9	8,430,471.0
Standard deviation	5,213,418	48.8	156.1	343,719.2	1.23	12.9	38,200,000.0
Maximum	1.530	155.8	258.7	1,498,287.0	4.85	25.1	23,000,000.0
Minimum	7502.5	0.74	76.2	7694.0	0.01	-32.1	3,2776.0
Total observations	45	45	45	45	45	45	45

Source: Own estimation. RER: Real exchange rate

Table 2: ADF and PP unit root test results

Variable	ADF-statistics		PP-statistics		Model	Lag order	~I (d)
	Level	1 st difference	Level	1 st difference			
TTR	-0.235	-4.493*	-0.527	-6.169*	No constant	2	I (1)
RER	-1.391	-2.286*	-1.205	-4.066*	No constant	2	I (1)
IPI	-0.434	-3.492*	-0.282	-3.820*	No constant	2	I (1)
AGO	-1.312	-2.504*	-1.427	-2.012*	No constant	2	I (1)
TWR	-0.765	-1.973*	-1.352	-4.229*	No constant	2	I (1)

*Denotes significance at 5% and the rejection of the null hypothesis of presence of unit root. The optimal lag lengths were chosen according to Akaike's final prediction error, and Akaike's information criterions. The PP and ADF critical value is -1.950. Source: Own estimation. PP: Philips-Perron, ADF: Augmented Dickey-Fuller, RER: Real exchange rate

Table 3: Results of the impact of trade and exchange rate policy on export on aggregate real sector performance

Variable	Equation 1		Equation 2		Equation 3	
	Coefficient	P	Coefficient	P	Coefficient	P
Log (RER)	-3087.87 (2.11)	0.0060	-0.8781	0.0000	-	-
Log (IPI)	31196.11 (2.09)	0.0113	-	-	0.91856 (4.2889)	0.0001
Log (TWR)	24.2576 (3.59)	0.0017	1.4155 (2.4343)	0.0188	4.7949 (16.7914)	0.0000
Log (TTR)	3796.09 (2.11)	0.502	0.16512 (0.2506)	0.5134	-1.0428 (-8.2767)	0.0000
R ²	0.7518		0.9117		0.9559	

The figures in the parenthesis are t-statistics. Source: Own estimation. RER: Real exchange rate

Having ascertaining the stationarity or otherwise our variable, further analysis was carried out using OLS, without the apprehension of estimating spurious regression results. In order words, we legitimately estimated our models to obtain long-run equilibrating relationship among our variables and the results are presented in Table 3.

The results in Table 3 reveal that the coefficient of import variable is positive and statistically significant at 5% level. This implies that import accentuates export performance. This confirms the importance of imported inputs in production activities, including production for export. The result further shows that trade policy opens access windows of export producers to foreign input, although empirical results show that RER that has negative and significant impact on export performance. This implies that the various exchange rate regimes in Nigeria produced the undesirable result of inhibiting export performance. This finding is in tandem with Ayodele (1997), Ubom-Udok (1999), Ogun (2004) and Adewuyi and Adeoye (2005) who also found that exchange rate has negative impact on output and non-oil exports. It can also be observed from the results that terms of trade has not been favorable to the extent of significantly promoting export performance.

The result of the sub-sectoral analysis of the impact of trade and exchange rate policy is presented in Table 4.

Table 4: Results of the impact of trade and exchange rate on export performance in the sub-sectors of the real sector

Constant/ variable	Equation 1		Equation 2	
	Coefficient and t-statistics	P	Coefficient and t-statistics	P
Log (RER)	0.15912 (0.6795)	0.3036	-	-
Log (IPI)	-	-	0.7324 (3.0022)	0.0082
Log (TWR)	13.4532 (6.5462)	0.0000	9.6512 (8.1254)	0.0000
Log (TTR)	-0.05654 (-0.2314)	0.6888	-0.0832 (-0.6432)	0.5885
Sub-sectoral impact of trade policy variables				
AGO_RER	-	-	0.1234 (1.2315)	0.0492
AGO_IPI	0.1230 (1.4321)	0.1489	-	-
MAO_RER	-	-	-0.0001 (-1.7321)	0.1019
MAO_IPI	0.1098 (4.2149)	0.0000	-	-
R ²	0.6109		0.8764	

The figures in the parenthesis are t-statistics. Source: Own estimation. RER: Real exchange rate

It can be seen from these results that while RER has negative impact on both agricultural and manufactured exports, its impact is significant on manufactured exports only. This implies that exchange rate regimes in Nigeria have neither produced the desired results of enhancing agricultural exports nor manufactured exports. The result suggests that exchange rate policy has discouraged manufactured exports because its production highly depends on imported inputs. The results underscore the importance of foreign inputs in agricultural and manufacturing production activities for developing countries like Nigeria, particularly export production. This further reinforces the earlier findings that imported inputs are crucial to production activities in the real sector of the economy.

5. CONCLUSION

Empirical results suggest that the various exchange rate regimes in Nigeria have not produced the desired result that accentuates export performance. Results reveal that imported input and real world income promote export performance of the entire real sector, while terms of trade has insignificant impact. The sub-sectoral analysis reveals that exchange rate regimes Nigeria over the years have neither produced the desired results of enhancing agricultural exports nor manufactured exports. This suggests that exchange rate policy has discouraged manufactured exports because its production highly depends on imported inputs. This outcome underscores the importance of foreign inputs in agricultural and manufacturing production activities in developing countries like Nigeria, particularly export production.

The policy implication of the above findings is that there is need to achieve an equilibrium exchange rate that when combined with export incentives will promote non-oil exports in Nigeria. This will ultimately raise international competitiveness and merchandise terms of trade which will in turn enhance the demand for exports and hence, foreign exchange receipts.

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