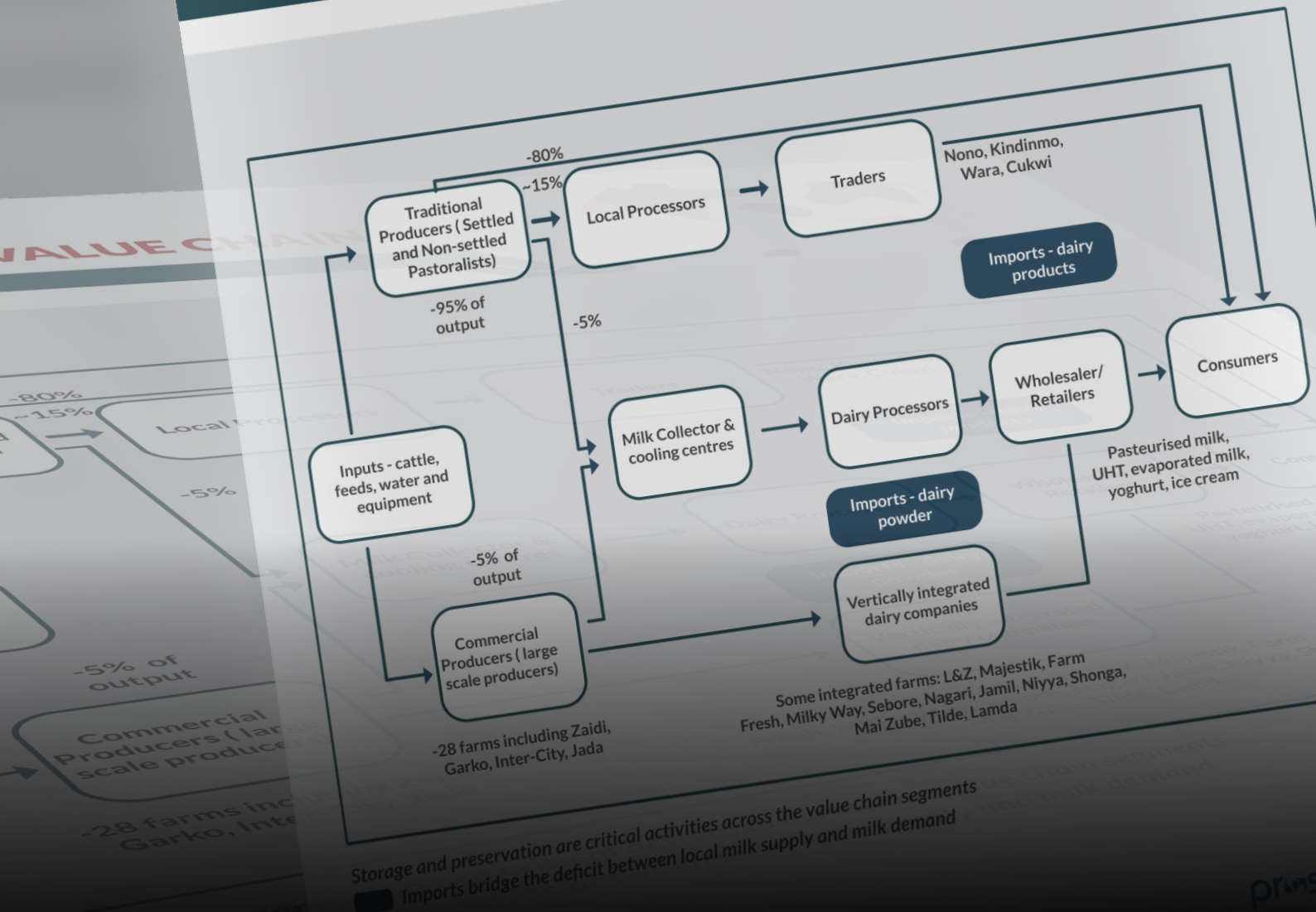


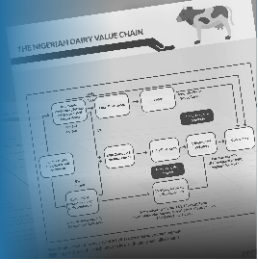
THE NIGERIAN DAIRY VALUE CHAIN



The FX Restriction on Food Import Gamble: Working From a New Play Book

September 2019

The FX Restriction on Food Import Gamble: Working From A New Play Book



Nigeria's Central Bank Governor, Mr. Godwin Emefiele, on July 2019 announced that the banking sector regulator would subsequently deny importers of milk (and other food items) access to the CBN-managed official foreign exchange market and indeed prevent access to any other bank-related source of foreign exchange purchase. The announcement threw companies like [Friesland-Campina WAMCO](#), manufacturers of Peak evaporated and powdered milk and [PZ Cussons](#) manufacturers of Coast milk into a disbelieving haze. Directors of the companies called for emergency management meetings to rethink their business models and come up with new operational strategies.

The Schools, the Thoughts

CBN's exchange restriction policy has attracted a number of comments from two distinct schools of thought; the first school supports the Central Bank of Nigeria (CBN) and argues that restricting access of food importers to the official foreign exchange market would encourage domestic production of the items (such as milk) and reduce pressure on the country's foreign exchange reserves, thereby strengthening the external value of the naira. The second school argues that Nigeria should develop market areas where it has a competitive trade advantage and produce goods and services at market competing prices; this is the classic free trade argument that is smart but contextually naïve.

In a global market place where countries create trade architectures that give them trading advantages above their competitors and generally work outside the classical interpretation of competitive economic production, referencing standard economic models of trade competition could prove dangerous, especially for countries like Nigeria dependent on a monocultural commodity export such as Crude Oil.

So Who Benefits From FX Restrictions?

The Beneficiaries

The identifiable beneficiaries of the restriction on FX would include but would not be limited to:

- ❶ Cattle herders (who theoretically should see the domestic demand for fresh milk rise)
- ❷ Government (lower pressure on FX demand, higher domestic tax revenue)
- ❸ Exporters (not clear who these are for now)
- ❹ Other local operators in the domestic supply chain (logistics companies, cooling van operators, loading and off loading dock labourers, banks, distributors and retailers)
- ❺ Growers of Napier grass (more herders will need the grass to improve milkyield per cow)
- ❻ Foreign ranchers of high-milk yield cows (from countries such as Argentina, Brazil, USA and Australia)

The Losers

Losers of the policy initiative:

- ❶ Local consumers (cost of milk will rise)
- ❷ Manufacturers of powdered and evaporated milk (Friesland-Campina WAMCO and PZ Cussons. Production costs will rise and quantity will fall as breakeven costs go up on lower sales volume)
- ❸ Banks (large manufacturers may see business volume decline and therefore reduce banking transactions)
- ❹ Distributors and retailers of evaporated milk will, at least in short term, see sales volume fall
- ❺ Foreign firms that export milk powder to Nigeria will see export volumes decline
- ❻ Customs (customs revenue on the \$1.2bn annual import will decline)
- ❼ Infants (working mothers will need to look for local substitutes for milk-based baby formula)
- ❽ Confectionary companies (companies like Nestle and Cadbury that produced FMCGs with large milk components will see costs escalate)

Looking for fresh Ideas

The CBN's decision to restrict the access of food importers to official foreign exchange markets has some short term merit but cannot resolve the primary medium to long term problems of low national productivity and weak production ecosystems'. The assumption that by restricting food imports, the country can increase domestic food output is a long shot at optimism. Nigeria's food production problems relate to much more than import competition; the problem relates more to some of the following:

- ❶ Poor production methods and inadequate application of technology to local production
- ❷ High cost of domestic financing
- ❸ Poor domestic storage facilities
- ❹ Weak logistic transport networks
- ❺ Gaps in the domestic production value chain
- ❻ Land title challenges that restrict access to domestic loans
- ❼ Absence of a high volume, high liquidity domestic commodity market

The restriction of importers access to foreign exchange (FX) will not eliminate these problems which relate more to fiscal policy than to issues of the exchange rate and money supply. Hacking at the reluctance of local companies to produce food in large domestic quantities requires providing an operating environment that makes local production cost-efficient and scale-effective. The best approach to 'nudging' production along specific lines is not 'punishment' but 'incentives.' The domestic food value chain must be made sufficiently competitive to make the prospect of imports unattractive. A few measures would include:

- ❶ Providing tax holidays of five years for industries involved in beef and other food-related processing activities that achieve at least 60% local value addition, especially for companies that manufacture exportable products like gelatin, oleo, glue, buttons, China

bones etc

- ❗ A tax rebate for companies that export processed agricultural goods; the rebate could start from a maximum of 6% and could gradually be scale down to 2% according to export value
- ❗ The storage part of the agricultural value chain process is a major problem, one way to get around this would be to construct facilities on a build, operate, and own (BOO) basis with the government guaranteeing a minimum off-take value monthly over a specified period during which the private investor would have recovered cost. After this period the government would remove the guaranteed 'floor' and allow free negotiations amongst economic agents.
- ❗ Alternatively, the government could enter into a build, operate, and transfer (BOT) arrangement with private investors, if it chooses to ultimately own the facilities for strategic national reserve reasons. Under this arrangement the government will still need to guarantee the off-take 'floor'.

The Economics of Milk

A review of the milk business is instructive. A few challenges limit the efficient and profitable production of the product, which industry analysts note majorly include the following facts:

- ❗ Cows need a minimum of three (3) litres of water to produce one litre of milk (but severe water shortages exist where cows currently congregate in Northern Nigeria).
- ❗ The fodder available to cattle in Nigeria is high in Lignin that disrupts conversion to milk, however, more recently Napier grass was introduced to the production value chain by the [Business Innovation Facility \(BIF\)](#) run by the [Convention on Business Integrity \(CBi\)](#) for PwC Uk and DFID. The new type of grass has increased yield by an additional two litres of milk per cow per day (single milking). The new grass variety is not yet available across the country and can only solve the dry season need for fodder if converted to pellets or silage in bags.
- ❗ Napier grass growth would create value-added products from its use in the beef nurturing process; however, access to water remains a problem. Major investment in infrastructure is needed, particularly in the grazing reserves where the government has allowed the majority of the dams to silt.
- ❗ Another challenge to productivity comes from the breed of cattle itself which needs to be improved if the dairy sector is to record the sorts of volumes needed for reliance on local value chains. The country is yet to have artificial insemination and embryo technologies that could be employed for breed improvement to ensure that in 5-10 years, milk yields could be significantly increased.
- ❗ Regardless of the amounts of milk available, without improved cattle management (extension and vet services) leading to acceptable milk handling and hygiene practices

amongst pastoralists, processing companies will refuse to uptake and at 1 government extension worker to 10,000 farmers, the situation appears bleak.

The restriction on FX to importers of milk products may spur activity at the very start of the domestic milk value chain and represent a boon to cattle herdsman that are prepared to be sedentary, but it will not supplant the persisting need for forex to purchase powdered milk for inclusion in powdered dairy-based beverages and baby food formulas for the foreseeable future (see Nigeria milk value chain in illustration below with charts 1-3 showing statistics of comparative domestic milk production and consumption).

When Data Speaks

As of 2016 (the period for which data is readily available), Nigeria produced 0.6m tonnes of milk as against Africa's average of 0.9m tonnes and Asia's average of 6.6m tonnes. The low 2016 milk consumption made Nigeria one of the world's lowest producers of dairy products. The squat production reflects the country's relatively small consumption. The per capita consumption of milk in Nigeria is 10litres per person, Africa's average is 28 litres per person while the global average is 40 litres per person, which, if put differently, means that Nigerians consume a quarter of the average litres of milk consumed globally per person. Nigeria's domestic production of milk is 34% of its total domestic demand, suggesting that the country has to import 66% of its annual milk intake of 1.7m litres. The demand and supply gap is significant but not overwhelming when juxtaposed against the average consumption levels on the continent and in the world.

The CBN's concerns about domestic milk production may be valid, but only within the broader context of a cattle production value chain rather than a domestic dairy production template. The importance of the CBN's desire to see more organized and strategically designed cattle production by far outstrips its concerns over milk production. The foreign exchange savings argument for the restriction to the official foreign exchange market by local milk manufacturers is less powerful than the argument that Nigeria can within a short period propel itself to the position of Africa's largest producer of sundry cattle products. The large value chain from cattle can serve as a major foreign exchange earner and engage a vast number of unemployed youths. The problem, however, is that the matter is less an issue of monetary policy than it is of fiscal vision, commitment and creativity.

The push towards strategic agricultural intervention should be the responsibility of the fiscal authority and not the CBN, which has the principal remit of ensuring monetary Policy stability within the framework of low inflation and sustained economic growth. It is the fiscal authorities that have the policy burden of presenting arguments for incentives to improve the domestic production of cattle as part of a wider industrial chain that enables a variety of industries to produce competitive products that compare favourably with global counterparts. The CBN's stab at fiscal policy by way of direct funding of agriculture or adopting policies to influence microeconomic activities is an aberration that is outside the normal role of a Central Bank.

Dark Production Holes

CBN's attempt to induce local production without considering the overall product value chain's efficiency and effectiveness will lead to large sums of money disappearing into black production holes. Cows are not single product enterprises, but they are multi-product businesses that require specialized inputs, incrementally advanced technology, seasoned expertise and guaranteed markets. The milk production value chain tried by Shonga Farm Holdings Limited in Kwara State, for example, had to contend with heavy commercial difficulties that almost bankrupted the venture. Part of the problem was that the cattle were not able to get a regular supply of special feed, and the poor power situation made it difficult to cool process pasteurized milk for storage and retail distribution and sale. In the early days the company lost 2,000 litres per day of milk to wastage or unsold volumes.

[Shonga Farm Holdings Limited](#) found out early in its efforts at producing and selling fresh milk in local markets that supply typically outstripped demand and that selling to an open market was a recipe for disaster. In other words, encouraging local milk production on a massive domestic scale without attendant demand assurances will make the dairy dream unviable, unsustainable and financially unrewarding.

The Real Deal

The production process that Nigeria (and its agriculture ministry) should be championing is cattle. The cattle business has a production value chain from which the country can evolve several world-beating businesses from which young Nigerians can find meaningful employment (Nigeria has as at Q3 2018 an unemployment rate of 23.01% and an underemployment rate of 20.01%).

The cattle business has Omni-products that create a vast value chain in manufacturing of goods ranging from leather, drugs, adhesives, buttons, fertilizer, paper, toothbrushes, to edibles such as milk, yogurt, corned-beef, sausages, ice cream chewing gum, and candies. If the CBN must truly step outside the politics of cattle breeding in Nigeria, it needs to find common ground with the agriculture ministry to do the following:

- ❶ Provide start up tax exemptions for investors in cattle rearing and dairy products (a fiscal responsibility)
- ❷ Support cattle production through a variety of value chains at subsidized lending rates based on milestone attainments and project scalability (a monetary policy remit). The subsidy will follow a 'sunset' plan and will disappear at the expiration of the approved sunset period.
- ❸ Provide Infrastructure to support the processing and storage of cattle by-products, including milk. The infrastructure and processes will mean collaboration with the Ministry of Power to create special situations that allow private investors in the cattle value chain to embed power generation that exceed 1,000mw/h.

The Dairy Value Chain

In a recent report on Agriculture in Nigeria, International Consulting firm, PwC, provided insight into the local dairy value chain. Traditional producers provide 95% of the local supply, while large-scale commercial producers make up the balance of 5%. The commercial producers are made up of 28 farms which include Zaidi, Garko, Intercity and Jada.

Of the amount of milk produced by local pastoralists, 80% goes directly to consumers while 15% goes to local processors (see value chain below). The high percentage that goes directly to consumers undermines the price of local milk and the value addition that would enhance the income of dairy farmers. The 80% traded primary milk production ends up with milk vendors who turn it into Nono, Kindinmo, Wara and Cukwi. The 5% production by modern commercial producers ends up as pasteurized milk sold by large corporate producers in the form of powdered and tinned milk.

Illustration 1 The Nigerian Dairy Value Chain

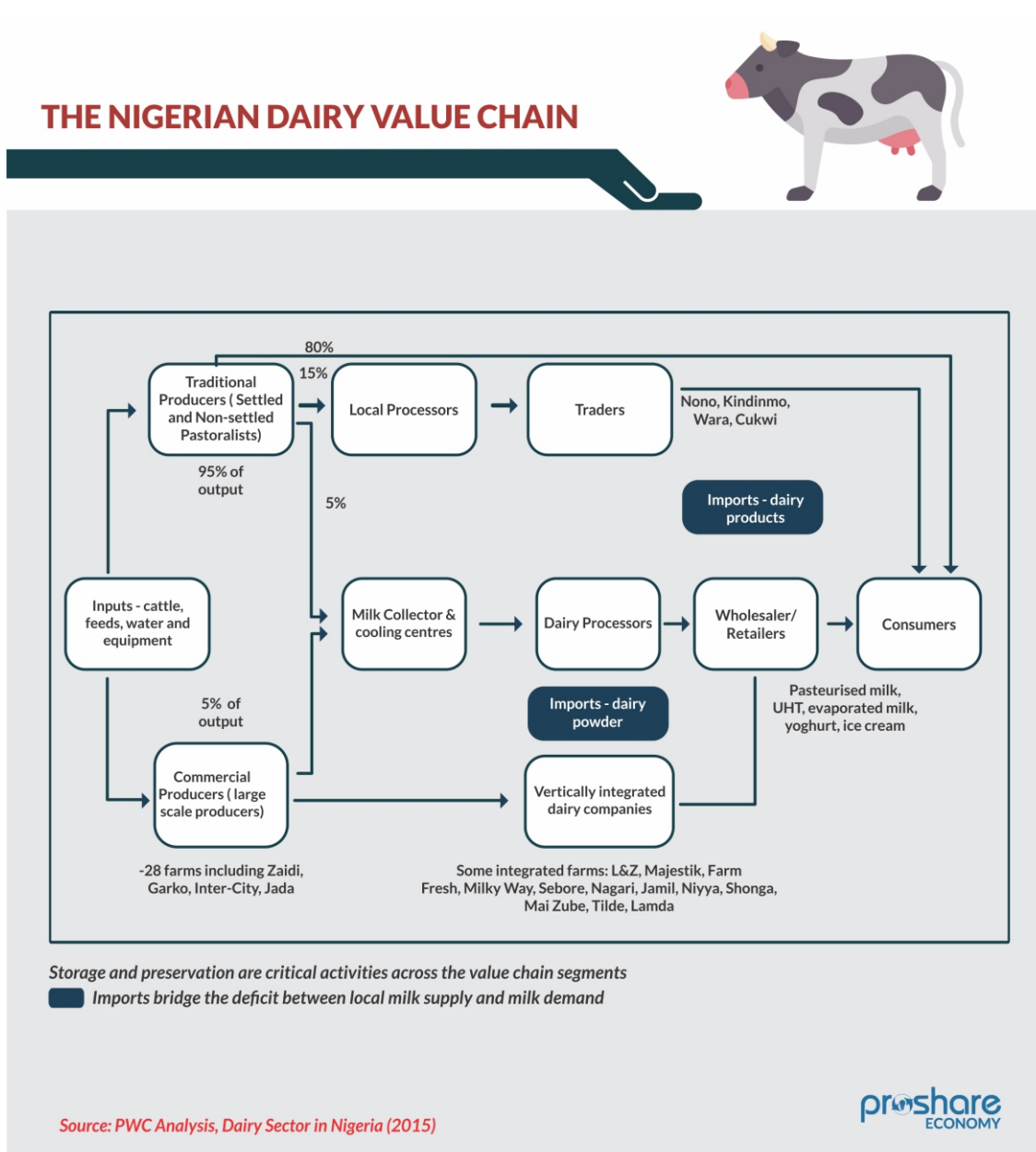
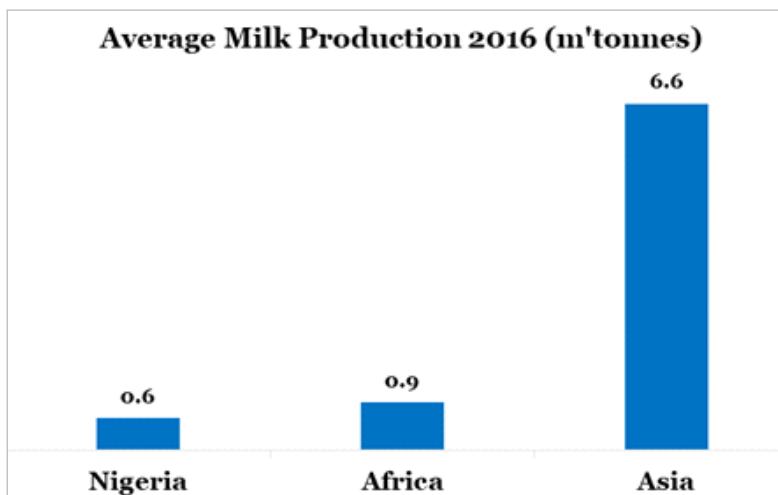
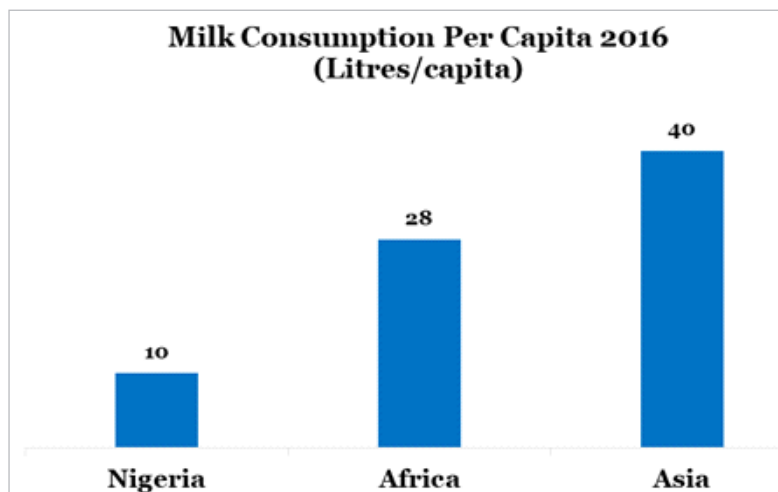


Chart 1 Average Milk Production in Nigeria 2016 (m'tonnes)



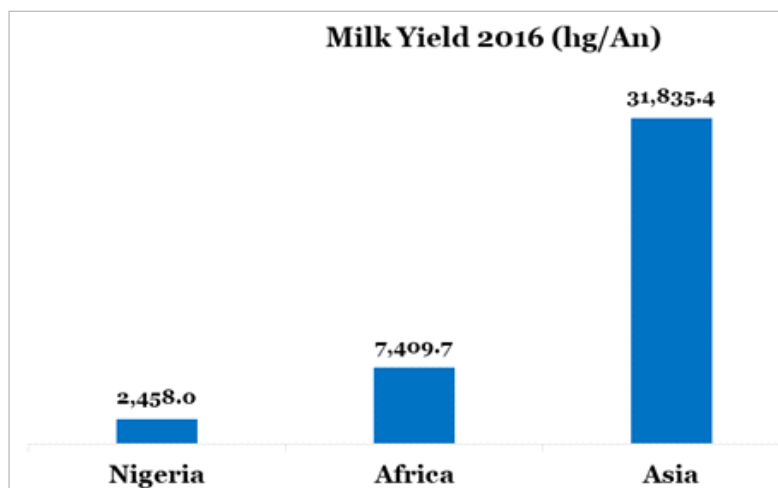
Source: PwC, Proshare Research

Chart 2 Average Milk Consumption in Nigeria 2016 (litres/capita)



Source: PwC, Proshare Research

Chart 3 Milk Yield in Nigeria 2016 (hg/An)



Source: PwC, Proshare Research

Where Are The New Jobs?

Jobs will come about at the very start of the value chain. Some low hanging fruit jobs will include the following:

- ❗ Great expanses of Napier grass need to be cultivated, harvested, pelletized, turned into bagged silage, transported and sold.
- ❗ Clusters of herdsmen need to settle around where they have access to water, fodder, vet and cattle management services, milk aggregation and cooling systems, transportation and off-takers creating a multiplicity of opportunities for investment and job creation.
- ❗ On the Ladduga Grazing Reserve in Kachia LGA of Kaduna State, BIF in partnership with Fulani communities, has set up a system that can process up to 1,000 litres of yogurt (in 2 shifts). This gives employment to about 40 persons. If every system to produce 1,000 litres of yogurt requires this, the limitation on job creation will be investment in the water, fodder, extension, processing equipment and so on.
- ❗ Many low paid jobs will be created, and availability of dairy products increased, but there would still be a wait of a few years before sufficient volumes could be aggregated daily to cause enough powdered milk factories to be established so that Nigeria reduced its forex demand for importing such a commodity.

The increase in jobs for raw milk is clear, but this is not likely to justify the [restriction placed on FX](#) for the importation of powdered milk. It is important to note that Nigeria is a low milk consuming nation (see chart 2 above) and the impression that the country will become a milk producing Eldorado, in the near term, is at best misleading. However, if the narrative shifts to a broader beef processing value chain, the CBN's intervention would appear to be more meaningful.

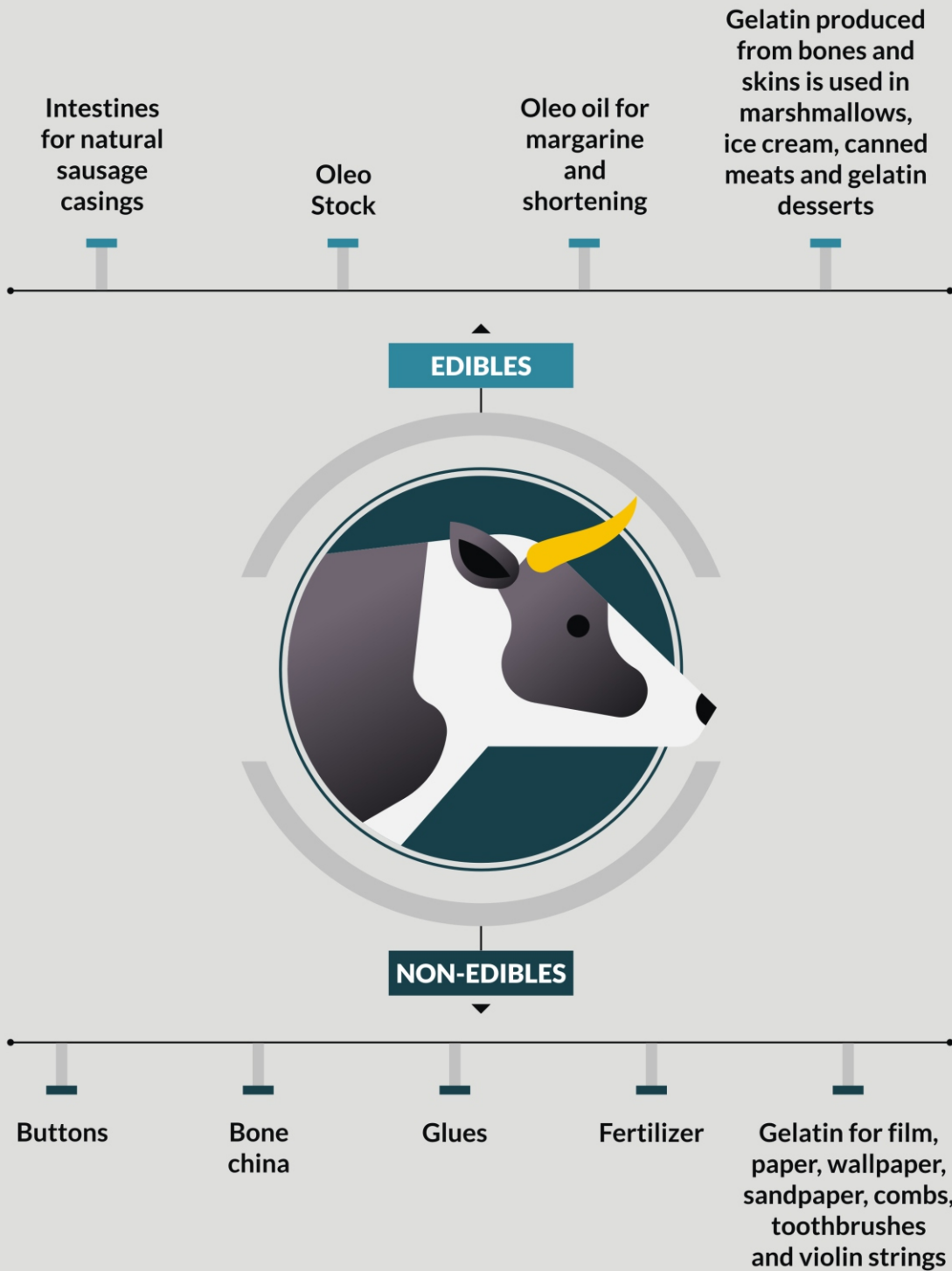
The processing of beef as a comprehensive multi-product enterprise will increase short and long term employment through improved animal husbandry and scaled production and multi-product diversification into commercial items such as:

- ❗ Fertilizer
- ❗ Buttons
- ❗ Glues
- ❗ Oleo
- ❗ Bone China and,
- ❗ Gelatin

These are in addition to the normal hides and skin and edible beef.

When the business and economics of cattle rearing supplants the politics of the cow and its herder, the economic value chain moves along the required traditional lines of production efficiency, economies of scale and pricing (see illustration 2 above).

COW PRODUCTS



Source: PWC Report on Agriculture 2017



Much Ado About FX

The policy of restricting access to forex for importation of powdered milk and other food products will at worst create scarcity of forex for importers leading to an increase in prices of basic products (utilizing imported raw materials), ultimately fuelling inflation or at best expose the allocative and operational inefficiencies in the fiscal management of the country.

The CBN argument that the country spends \$1.2bn annually on milk import is concession to an argument of preferred resource allocation and not foreign reerve pressure. For example, the country spent- \$12.5bn in 2018 on fuel import; the fiscal authorities also spent approximately \$1bn on Hajj and Jerusalem pilgrimages which are supposedly private religious obligations; the monetary authorities bailed out deposit money institutions (DMBs) through AMCON to the tune of \$18bn (N6.5tr); the FGN granted Tax and Import Duty waivers for some large corporates in Nigeria totalling \$2.8bn (2011-2015), according to a customs service report. Another N4.65 trillion was allegedly lost to importers by the FGN through waivers in 2017 & 2018 due to the non-implementation of the Import Duty Exemption Certificate (IDEC) project. In other words, the fiscal and monetary challenge is not one of import substitution but more an issue of fiscal and monetary policy harmonization,

Depoliticizing exchange rate administration would go a long way in realigning domestic production operations to strategic national objectives. A regime of incentives for a beef value chain would prove more effective than a punitive restriction placed on importers of milk products.

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REGULATORY CONVERSATIONS 4.0

THEME:
FOREIGN EXCHANGE RESTRICTIONS ON FOOD IMPORTS AND IMPLICATIONS FOR REGULATING AND GROWING THE NIGERIAN ECONOMY

ACCESS DENIED

Tuesday, September 24th, 2019
The Incubator- 7/8 Chief Yesuf Abiodun Way, Off City of David Road, (same street with Four Points Sheraton), Victoria Island, Lagos.
9h00 (registration/networking 8h30)

TARGET AUDIENCE: This event is anticipated to have in attendance about two hundred (200) participants comprising Regulatory Agencies such as The Central Bank of Nigeria, Directors- General of Ministries, Departments, and agencies of the Government. Private sector actors such as Chief Executive officers of companies (Large/ Medium/small) as well as other key players in the Business community and other related stakeholders.

For Confirmations please contact:
Yinka Johnson (+234-7013715571) at yinka.johnson@cbnigeria.com;
and Kitan Babalola (+234-08067829272) at kitan.babalola@cbnigeria.com

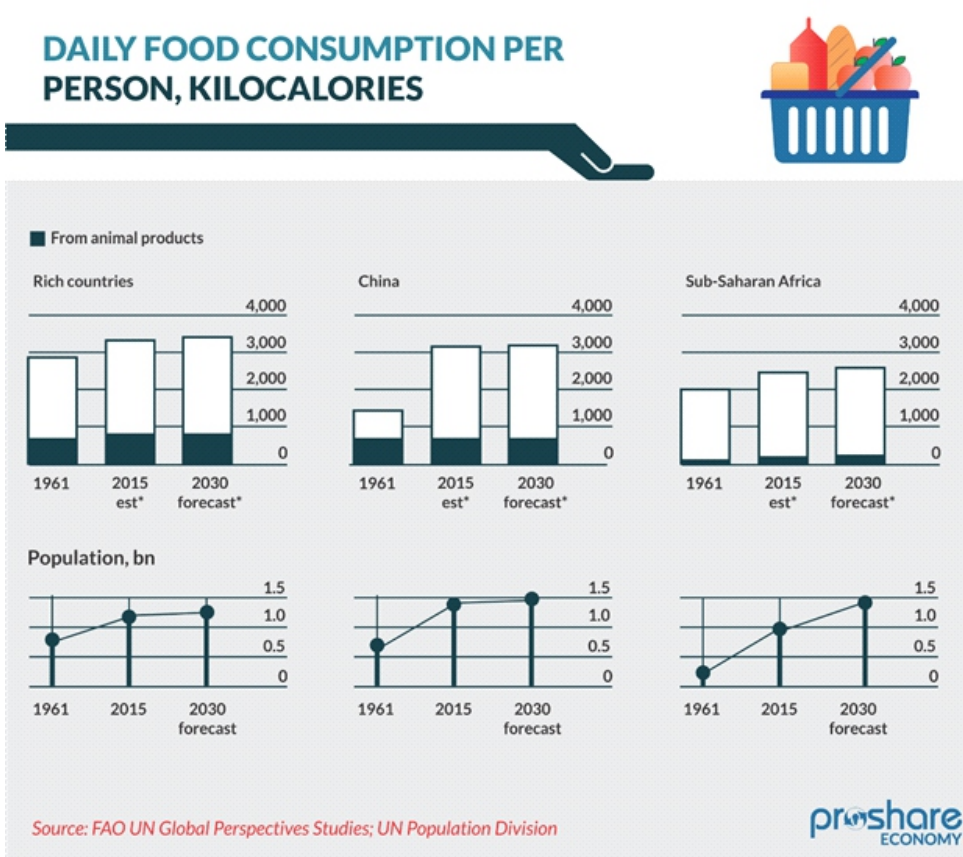
CBN: Putting Its Best Foot Forward

The CBN in its recent restriction of access of milk importers (and more recently its restriction on other food items) to FX has validated a festering political concern about cattle rearing in the country. The timing of the policy has inadvertently portrayed the financial regulator as a partisan actor in issues concerning cattle rearing; this should not be so. The CBN has hitherto lived up to admirable and strong professional standards of ethical commitment to the national economy, and it should remain an impartial agent of growth and development devoid of divisive optics.

Strategy Not Politics

The search for food sustainability may need to start in less obvious places. The animal husbandry business is going through strategic shifts as global vegan diets go on the ascendancy. One of the reasons for this development is that cattle and other farm animals take up 80% of land space and contribute only 18% of human protein intake. Dieticians believe that a lot more protein can be obtained from less use of land by resorting to veggie diets. If the trend accelerates, the global price of beef will tumble and cattle herders will need to rethink the economics of their business, but it needs to be said that so far meat consumption on a global scale does not look like slowing down significantly any time soon. Nevertheless the figures and forecasts of international agencies such as the [United Nations Food and Agriculture Organisation \(FAO\)](#) suggests a flattening in the consumption growth of animal meat over the next decade (see illustration 4 below).

Illustration 2 Cow Product Lines



In addition to concerns over the adverse economics of beef consumption, red meat has been associated with several human ailments ranging from Fibroids in women and cancer in both sexes. The leveling-off of meat intake will make it necessary for Nigeria to get smart. The beef, mutton and goat value chains need to be quickly harnessed to create an animal husbandry ecosystem that will continue to provide jobs and food. ***The restriction of access of food importers to foreign exchange should not be seen as an end, but a strategic pause.***

To pursue the domestic food expansion mandate properly three things (see illustration 3 below) must take place:

- ❶ Policy makers must Reimagine the countries food future over the next ten (10) years on the basis of current knowledge of concerns about CO2 emissions (a large amount of which can be traced to cows), population growth rates and changing global eating patterns
- ❷ Rethink the past, by identifying and deliberately adjusting present conduct in a way that addresses the limiting practices and beliefs of tradition.
- ❸ While they equally Reconsider our present approaches to food sustainability. Our present approach to agriculture inadequately addresses the imperatives of product value chains. For example, The CBN has restricted access of milk importers to FX but it has not harmonized policies with the fiscal authorities to ensure that the domestic milk value chain is capable of substituting foreign import of milk. Are cooling systems between the pastoralists and the large milk processing factories in place? Are the required storage facilities available to provide 'warehousing' of excess milk supply for onward sale at the end of specific production and sale cycles? Are high-milk yield cattle available to produce more than 1 litre of milk for every three (3) litres of water intake by local cows?

Illustration 3 Constructing Strategic Narratives



The desire to attain food self-sufficiency is unquestionably noble, but the mechanics of achieving the objective needs to be carefully calibrated to avoid disruptions to economic activity that could prove very expensive and trigger the 'Cobra effect' that speaks to the challenges posed by unintended consequences of policy.

Pushing Forward

In 2017 the Central Bank placed a [restriction on 41 import items](#) (and has since added a further 9 items to make it 50 items) as being unapproved for foreign exchange applications through the official FX window. According to the CBN the measure was designed to relieve pressure on the foreign exchange market and encourage local production of all goods on the restricted for FX list.

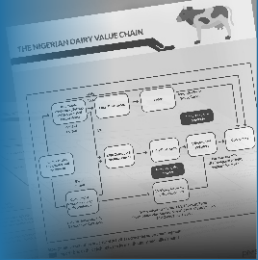
The CBN's action has a mercantilist logic, but it also creates distortions in domestic production incentives and pricing. For local manufacturers to succeed in domestic production and export they must be competitive, a protectionist strategy will not guarantee this without an accompanying policy of improved infrastructure and finance. The unintended consequence of the CBN policy could end as an increase in domestic prices of food commodities and a non-existent export market as a result of poor product quality and non-competitive pricing. The finance concept of 'moral hazard' occurs as the protection wall against imports lulls local producers into satisfaction with substandard output. The lower output quality passed to consumers at higher than global market prices improves producer surplus but shrinks consumer surplus, thereby unfairly reallocating income from producers to consumers.

The reallocation of income will not be sustained as hard-pressed consumers will likely react by either reducing consumption or resorting to buying better quality and lower-priced smuggled goods which in turn will lead in a failure of local industries and a reduction in government tax revenues as companies fold and employees lose their jobs.

Incentives Rather Than Restrictions

A better approach to encouraging local production would appear to be the use of incentives such as tax and rebates rather than exchange restrictions. Indeed with fiscal arrangements that support private enterprise through improved local infrastructure and contributions to strengthening private commodity value chains the microeconomics of food production would look more attractive and clearly sustainable.

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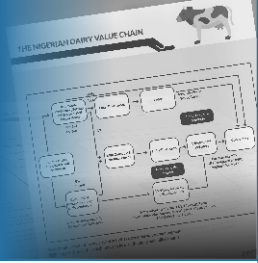
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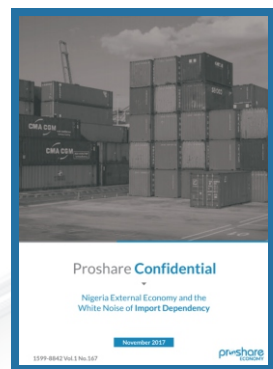
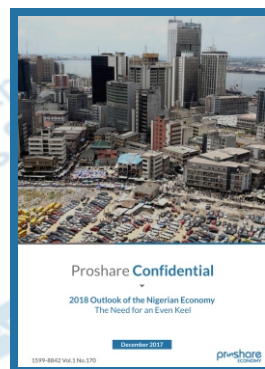
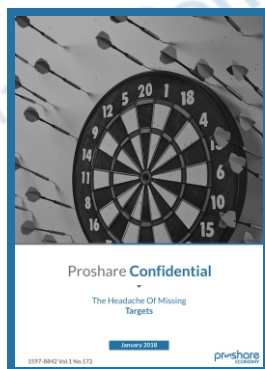
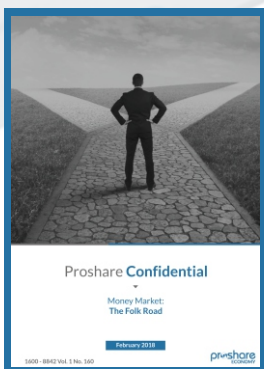
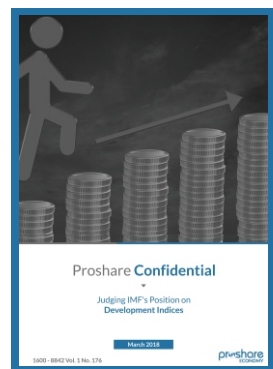
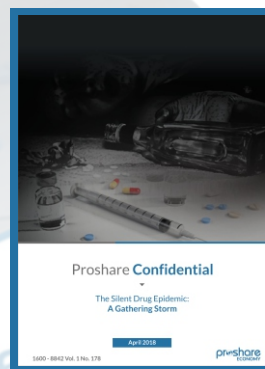
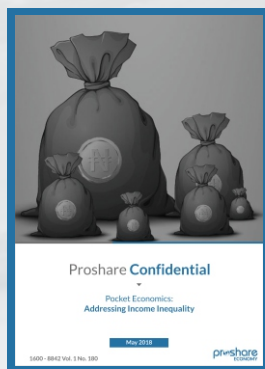
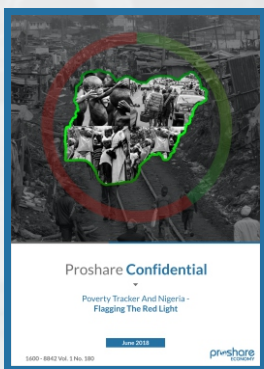
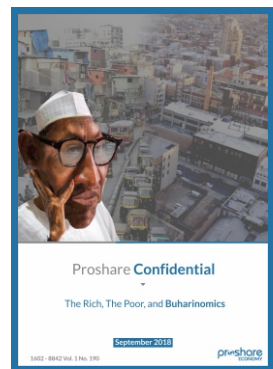
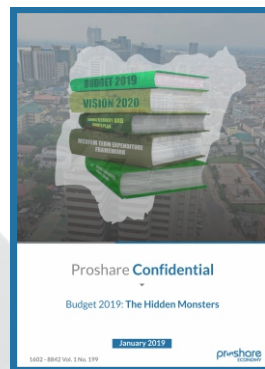
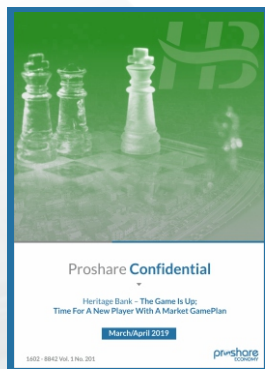
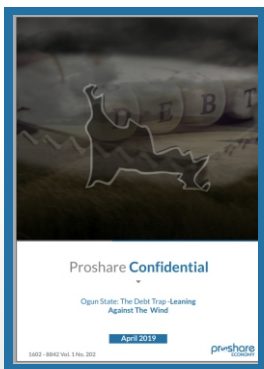
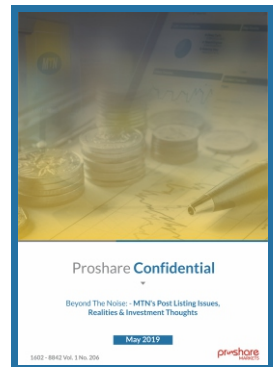
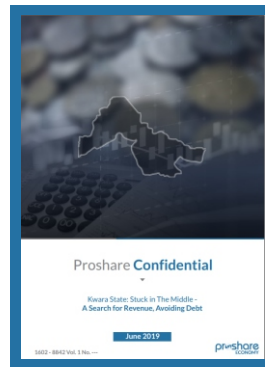
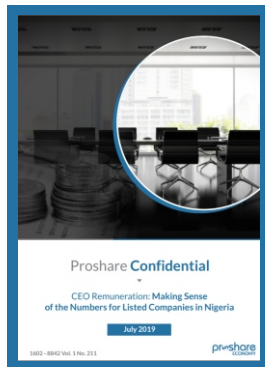
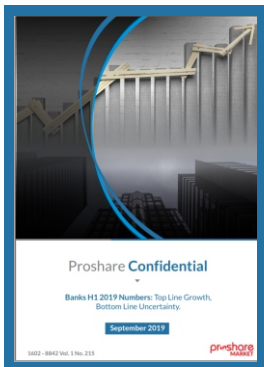
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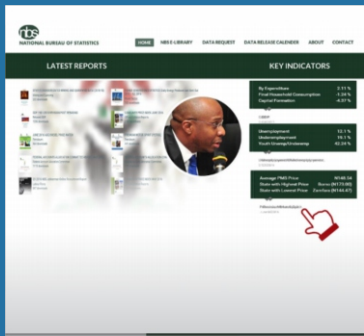


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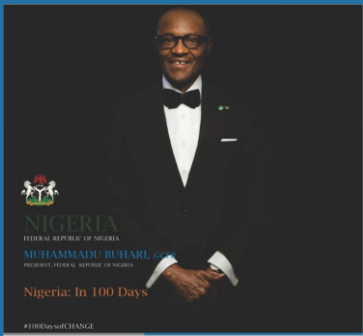
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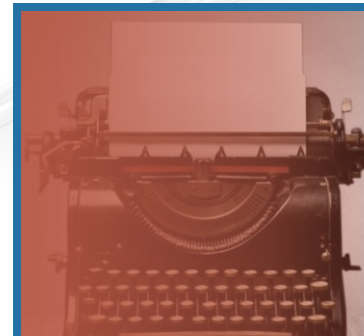


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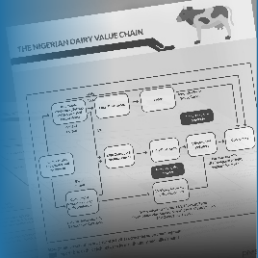
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