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Unlocking Trade-Led Growth in West Africa: The Moderating Role of Institutional Quality in a Dynamic Panel Analysis

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Abstract: This study examines the conditional effect of trade liberalization on economic growth in West Africa, with a particular focus on the moderating influence of institutional quality. A panel dataset covering 16 West African countries over the period 2017–2022 is employed to estimate a dynamic growth model using the System Generalized Method of Moments (System-GMM), which effectively addresses endogeneity and growth persistence. Robustness checks are conducted using Pooled Ordinary Least Squares (POLS) and Fixed Effects (FE) estimators. The results reveal three key findings. First, trade liberalization has a positive and statistically significant effect on economic growth in the region. Second, although institutional quality exhibits a negative direct effect, likely due to short-run adjustment and compliance costs, the interaction between institutional quality and trade liberalization is positive and strongly significant, demonstrating that governance effectiveness is critical for harnessing the growth benefits of openness. Third, the negative coefficient estimates for financial development and industrialization indicate structural inefficiencies, including credit misallocation and a continued dependence on low-value, resource-based production. Overall, the findings suggest that while West Africa possesses substantial potential for trade-driven development, meaningful gains remain constrained by weak institutional capacity and limited structural transformation. The study recommends targeted governance reforms, improved regulatory enforcement, strategic reallocation of financial resources toward high-value export sectors, and accelerated industrial diversification to ensure that trade liberalization translates into sustained, inclusive economic growth.

Keywords: Trade Liberalization, Economic Growth, Panel Data, System GMM, Governance Institutions, Institutional Quality

JEL Codes: F13, O43, O55, P16:

1. Introduction

International trade has historically served as a major engine of global integration, driving economic interdependence alongside cultural and intellectual exchange across diverse regions (Adeosun & Tabash, 2022; Dahal et al., 2024 and Celik et al., 2024). In recent decades, West African economies have intensified efforts toward trade liberalization, reducing quotas, protectionist tariffs, and exchange controls, to stimulate regional cooperation and accelerate growth. However, despite these aspirations, persistent structural weaknesses and governance challenges continue to limit the effectiveness of trade policy reforms in the region. While classical economists posited a mutually reinforcing relationship between trade and development, contemporary empirical evidence reveals that trade liberalization alone is insufficient to guarantee sustained economic performance. A growing body of literature confirms that the ability of trade to generate growth is conditional on the presence of strong institutional frameworks (Mehmood et al., 2023; Liko, 2024).

The theoretical mechanisms linking trade and growth are widely acknowledged. Trade enables job creation, market expansion, and the transmission of technological knowledge across borders, thereby enhancing productivity and domestic competitiveness (Ideba et al., 2025; Ogbuabor et al., 2024b). According to the Endogenous Growth Model (Romer, 1986), these technology-driven spillovers are essential for sustaining long-run growth beyond capital accumulation. In addition, countries rely on global exchange to access goods and services that cannot be efficiently produced domestically, reinforcing the export–import cycle as a fundamental driver of balanced economic development (Sowrov, 2024and Rufaedah et al., 2024). Although concerns remain that trade may exacerbate underdevelopment in resource-dependent economies, the prevailing empirical consensus suggests that, when supported by conducive domestic conditions, trade is a powerful catalyst for long-term development (Mamasoliev, 2024; Bajo-Rubio & del Carmen Ramos-Herrera, 2024).

West Africa is an economically significant and resource-rich trading region. Petroleum accounts for 61% of its total exports, while cocoa dominates agricultural exports (African Union, 2022). Nigeria remains the driving force behind regional trade, contributing more than 70% of total export receipts. Although trade volumes have grown in recent years, averaging USD 208.1 billion and generating a substantial regional surplus (African Union, 2022, the expected structural transformation and productivity gains have not materialized for many member states.

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This paradox has prompted scholars to highlight the central role of institutions in facilitating trade-led growth. According to New Institutional Economics, institutions function as the "rules of the game," shaping incentives and reducing transaction costs across economic activities (North, 1990). Weak institutions hinder the translation of external benefits, such as foreign direct investment (FDI) and knowledge transfer, into domestic productive capacity by heightening corruption, policy uncertainty, regulatory inconsistencies, and insecurity (Bhattarai et al., 2023; Gebrue, 2024). Conversely, sound governance, characterized by effective regulation, political stability, and rule of law, strengthens investor confidence and enhances policy efficiency, enabling economies to fully leverage trade opportunities (Mehmood et al., 2023; Liko, 2024).

Despite these insights, empirical evidence in West Africa remains fragmented. Most studies examine the independent effects of either trade liberalization or institutional quality on growth, without addressing the specific theoretical channel through which institutional quality may shape the outcomes of trade. As a result, there is limited understanding of why expanding trade openness has yielded divergent results across the region.

To address this gap, this study empirically investigates the moderating role of institutional quality in the relationship between trade liberalization and economic growth in 16 West African countries from 2017 to 2022. Using a dynamic System GMM framework complemented by robustness checks, the study contributes to the literature in three key ways: (1) it provides new region-specific evidence on the conditional nature of trade-led growth; (2) it constructs a composite institutional quality index using principal component analysis to reduce measurement error; and (3) it identifies the threshold of institutional effectiveness required to translate trade openness into sustainable economic development. By offering these insights, the study delivers actionable policy recommendations to strengthen governance structures and ensure that the growth benefits of trade are equitably realized across the West African sub-region.

2. Literature Review

2.1. Theoretical Literature

A. Theories on Trade Liberalization and Growth

Classical economic theories establish a foundational premise for trade liberalization as a driver of national growth. Ricardo's (2004 theory of comparative advantage emphasizes that nations benefit when they specialize in goods produced relatively more efficiently, while Smith (1937) advocates for the removal of trade barriers to strengthen overall global production efficiency. These theoretical constructs collectively suggest that free trade can enhance resource allocation and stimulate economic growth. This rationale is expanded in the Export-Led Growth (ELG) hypothesis, which argues that export expansion catalyzes productivity gains through economies of scale, managerial improvements, and knowledge spillovers (Krugman, 1990; Lucas, 1988). According to Endogenous Growth Theory (Romer, 1986), such spillovers facilitate innovation-driven growth, implying that trade liberalization, by exposing domestic firms to global competition, can serve as a pathway toward sustained economic development.

B. Theories on Institutions and Economic Growth

Nevertheless, trade alone cannot guarantee positive growth outcomes. The theoretical discourse on institutions reveals that structural and governance conditions shape the effectiveness of market mechanisms. Neoclassical institutional perspectives assume that markets are capable of self-regulation with limited governance intervention (Boland and Newman, 1979). Yet, New Institutional Economics challenges this assumption, asserting that institutions, defined as the formal laws and informal norms governing economic behavior, play a decisive role in reducing transaction costs, protecting property rights, and enabling efficient interactions (North, 1990). When institutions are weak, corruption, regulatory inefficiencies, and political instability undermine investors' confidence and hinder productive utilization of external opportunities. Therefore, institutional quality emerges as a crucial enabling condition for transforming trade-induced opportunities into sustained economic expansion.

C. Theories Linking Trade, Institutions, and Economic Growth

Integrating these theoretical perspectives suggests that institutional quality moderates the trade–growth relationship. While trade facilitates the inflow of technology and knowledge, the degree to which these benefits are retained and converted into local productivity depends on the effectiveness of governance systems. Strong institutions ensure contract enforcement, minimize uncertainty, enhance competitive resource allocation, and secure returns on investment. Conversely, poor institutional environments may distort market incentives, channel trade gains toward rent-seeking behavior, and reinforce commodity dependence. Therefore, as theorized by endogenous growth scholars and institutional economists, institutional quality determines the direction and magnitude of trade liberalization's impact on economic growth, indicating that trade-led development is conditional rather than automatic.

2.2. Empirical Literature

Empirical findings on the influence of trade liberalization on growth provide both supportive and contradictory evidence. Numerous studies conclude that open trade policies foster growth by expanding productive capacity and integrating economies into global value chains (Ogbuabor et al., 2024b; Jabbar et al., 2024). Judijanto and Azizs (2024) similarly demonstrate that international trade enhances regional growth and job creation, although such effects depend heavily on infrastructure availability and competitiveness. Moreover, Celik et al. (2024) confirm a long-term relationship between trade openness and productivity enhancement in African economies, reinforcing the ELG hypothesis.

However, the relationship is not universally positive. Studies such as Bajo-Rubio and Ramos-Herrera (2024) reveal bidirectional causality between trade and GDP in Europe, suggesting the presence of feedback mechanisms, while Amna Intisar et al. (2020) report regional variations within Asia, where causality differs between economic subregions. Moreover, excessive reliance on primary commodity exports and limited industrial sophistication can result in negative trade–growth outcomes in developing economies (Dahal et al., 2024). These findings collectively suggest that the benefits of trade are contingent upon structural characteristics and economic diversification levels. Therefore, trade openness may either enhance growth or intensify vulnerabilities depending on the domestic economic context.