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Institutional Quality and Economic Performance in Nigeria: A New Evidence

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Abstract: The question of whether institutional quality is an important driver of growth has been the subject of a growing literature in both developed and developing economies across the globe. This study revisits this relationship in Nigeria from 1981Q1 to 2016Q4 and discusses the relevant policy implications for post Covid-19 Nigeria. The study adopted the ARDL approach which uses a bounds test approach based on unrestricted error correction model (UECM) to test for a long run relationship among the relevant variables. The findings indicate that institutional quality impacts negatively but insignificantly on growth in Nigeria, both at the aggregate and sectoral levels. However, initial output growth levels, capital and labour were found to be important drivers of growth in the country, while trade is growth-retarding. The study concludes that in this post Covid-19 era in Nigeria, there is need to improve the quality of socio-economic and political institutions in the country so that a more robust impact of these institutions can be felt in the economic performance of the country both at the aggregate and sectoral levels.

Key words: Institutional Quality; Economic Performance; ARDL Model; Nigeria

I INTRODUCTION

The relationship between institutional quality and economic performance has been the subject of a growing literature in both developed and developing countries across the globe. This is because no economy exists in a vacuum. There are certain institutional factors that play important roles in the growth of every economy. For instance, lack of political rights (i.e. freedom to participate in the political process), lack of respect for the rule of law and civil liberties (such as the rights to free expression, to organize or demonstrate, and to freedom of religion, education, travel, and other individual rights), poor government regulations, and high level of corruption have been blamed for the economic stagnation in most developing countries (Siba, 2008). North (1991) defined institutions as the rule of the game in a society or more formally, the humanly devised constraints that shape human interaction. Benyah (2010) explained institutional quality as the extent to which procedures by regulatory authorities foster investor protection and enhance greater access to funds for borrowers. Dysfunctional institutions generally render the economic environment unproductive and obstruct trade, thereby encumbering the growth objective of an economy (Anyanwu & Yaméogo, 2015)

Figure 1 (in appendix) reports the growth performance of the Nigerian economy. Panel A reports annual GDP growth while Panel B reports annual GDP per capita growth. Both panels aptly capture the poor performance of the Nigerian economy in recent years, especially the last recession of 2016 during which output plummeted and GDP per capita growth remained in the negative region. This raises concerns on the role of institutions in the Nigerian economic growth process. Thus, this paper examines the impact of institutional quality on economic performance in Nigeria. However, unlike the extant literature which is based on the traditional institutional variables documented in the World Governance Indicators such as control of corruption, government effectiveness, regulatory quality, rule of law, political stability and absence of violence/terrorism, and voice and accountability, this paper derives an institutional quality variable based on the data from Freedom House, which monitors political freedom in various countries across the globe on annual basis.

II AN OVERVIEW OF THE EMPIRICAL LITERATURE

Following the initial studies by Mauro (1995) and Knack and Keefer (1995), a growing empirical literature on the role of institutions in driving growth has emerged. Some aspects of this emerging literature show that institutions play important roles in Africa's growth performance. For instance, in a study aimed at establishing the factors contributing to Africa's growth performance, Mijiyawa (2013) found that government effectiveness was one of the key drivers of growth over the period 1995–2005. Similar results were obtained by Anyanwu (2014) who found that government effectiveness was an important driver of growth in Africa during the period 1996 - 2010. Furthermore, both Anyanwu and Yaméogo (2015) and Mijiyawa (2015) document that political instability, which is a major component of institutional quality, hinders foreign direct investment inflows into Africa, and thus impedes growth. Chikalipah (2017) documents that in SSA, strong institutional environment impacts positively and significantly on the performance of microfinance institutions, which constitute an important engine of growth in the sub-region. Other recent studies, such as Malikane and Chitambara (2017), show that strong democratic institutions promote economic growth in Southern African economies.

In West Africa, Iheonu et al. (2017) investigated the impact of institutional quality on economic performance from 1996 to 2015 using a panel of 12 West African economies. The study used the traditional measures of institutional quality such as control of corruption, government effectiveness, regulatory quality and rule of law, and adopted fixed effect, random effect and panel two-stage least square models. The results overwhelmingly showed support for positive and significant impact of institutions on economic performance. Other studies that have shown that institutional quality is an important driver of growth in Africa, especially in West Africa include Ojapinwa (2017), Kebede and Takyi (2017), Amin (2013), and Kilishi et al. (2013).

In Nigeria, Dandume (2013) studied the relationship between institutions and growth performance using the ARDL approach. The findings indicate the existence of long run relationships between institutions and economic growth as well as a two–way causal relationship. Okoi, Okoi and Bassey (2015) also studied the relationship between institutional quality, macroeconomic policy, and economic development in Nigeria from 1995 to 2013, and found that contrary to Dandume (2013), the impact of domestic institution on Nigeria's development indices is insignificant. The findings of Okoi, Okoi and Bassey (2015) are however consistent with those of Iyoboyi and Pedro (2014), which also established that substantial amount of the changes in macroeconomic performance in Nigeria is not due to the quality of institutions. These conflicting findings in the extant literature for Nigeria means that a large scope still needs to be covered towards a more comprehensive understanding of the role of institutions in Nigeria.

Another recent study that has contributed towards a better understanding of the institutions-growth relationship in Nigeria is Olayungbo and Adediran (2017). This study investigated the effects of oil revenue and institutional quality on economic growth in Nigeria using annual data from 1984 to 2014 and the ARDL approach. Overall, the study established that institutional quality is important in explaining the relationship between oil revenue and economic growth in Nigeria. Akinkunmi (2017) also used the ARDL approach to establish that in the period 1960 to 2015, political stability and political freedom have impact negatively but insignificantly on economic growth in Nigeria.

The foregoing overview of the literature indicates that the debate on the role of institutions in Nigeria's economic growth has just begun. However, it must be stressed the extant literature for Nigeria is yet to derive institutional quality variable from Freedom House database, which monitors political freedom in each country on an annual basis. For each country, the Freedom House institutional quality dummy variable takes the value of 2 for the classification free, 1 for partly free, and 0 for not free. We find that the dummy index ranged between 0 and 2 for Nigeria. Studies like Alexiou et al. (2014) have used the Freedom House institutional quality data with great success. This study will exploit the Freedom House dataset to