TOWARDS A SUSTAINABLE ECONOMY: ECONOMIC INSTITUTIONS AS A CRITICAL FACTOR FOR ECONOMIC GROWTH A CASE OF NIGERIA

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A B S T R A C T

The present paper discusses the importance of economic institutions as critical factor that determine whether a resource rich economy would be successful or not. It elucidates the reasons for differences in economic growth among countries in spite homogeneous culture, population, resources. The distinct contribution of a good economic institutions to create market economy which allocate, distribute available resources in efficient way for higher revenue and rent for the benefit of the majority cannot be overemphasized. Factors such as geography, culture and historical antecedent (colonial affiliation) play important role in the life a nation but not as viable economic institutions. The paper concludes by relating the Nigeria economic problem amidst abundance resources to ineffective institutions. It is incumbent on the political power holders/elite to embark on institutional reforms to take the country out of the wood.

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INTRODUCTION

The link between resource abundance and economic growth has been an object of research since the 1960s. Countries around the world are blessed with various degree of resources both human and material. The easy reference that come to mind when considering example of countries blessed with human population are China and India as they constitute over 42% of the world population. Singapore and Switzerland would fit in for resource scarce economy. Human and material resources have contributed to the development of nations. The benefit of material resources depends on human manipulation and innovation, hence no material resource will be useful without human capital. Abundance of resources is not enough to guarantee prosperity for the people but depends on many factors majorly human organization and institutions. Institutions can be referred to as the way a society is organized to meet societal challenges. Acemoglu (2000) opines that they are the “rules of the game” which determines the “economic performance and yardstick to understand the vast cross-country differences in prosperity”. Stefan (2007) defines institutions as the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction”. The exploration of the natural endowment to attain economic growth is hinged on economic, political and social interaction institutions. This is because institutions are humanly devised, set of rules and incentives to promote development. A country where institution is efficient, effective and transparent resource abundance would achieve economic prosperity for the people. Many developing economies blessed with resource abundance failed to attain economic growth not because of lack of market, human capital or quality of resources available but inefficient institutions. IMF (2008) on its regional reports about sub-Sahara Africa discovered that fast grower and low grower economies are of equal number. It suggests that natural endowment alone does not translate to growth opportunities for a country but strong institutions. Sierra Leone and Botswana are endowed with diamond in commercial quantity. Botswana has been successful in making use of the revenue and rent from the diamond export to achieve economic growth while Sierra Leone people are wallowing in poverty and devastating warfare and diseases.

Nigeria is an example of a country rich in oil, gas, gold, bitumen and many others but unable to annex the opportunity for the greater benefit for its people over the years. Unlike resource poor nations in Asia and Europe that have attained economic growth (Oomes & Kalcheva, 2007). From the literature it can be deduced that many countries that are not naturally endowed with resources are far more prosperous and wealthy than many others blessed with resource. Hong Kong, Switzerland and Singapore do not have any resource they can lay claim on. However, distinction has to be made that resource rich country with efficient institutions like United

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States and United Kingdom also enjoy high rate of economic growth(Gylfason, 2000).

This paper would therefore examine the essence of institutions as critical factor to attain economic growth in resource abundant economies. The section two would examine theory and empirical evidence and section three concludes and make recommendations.

THEORETICAL FRAMEWORK AND LITERATURE REVIEW

Classical Theory of Resource -Based Growth

The theory of comparative advantage as it referred to by the mainstream economists provides a useful account of how countries should under perfect market conditions can concentrate on the export of the products that it can produce at the lowest relative cost (Todaro & Smith, 2009). The classical economists grounded this theory on the assumption of a static model that trade on a single variable factor that is labour, perfect specialization approach to demonstrate the gain from trade (Igberaese & Hague, 2013). This theory formed the basis of free trade, specialization and international trade. Comparative advantage theory has been modified and refined to fit the nature of twenty first century by Eli Hecksher and Berlin Ohlin. Hecksher-Ohlin extends the theory to accommodate the different inherent in factor of production (land, labour and capital).

The neo-classical model of free trade, which postulates that countries will tend to specialize in the production of the commodities that make use of their abundant factors of production. They can then export the surplus in return for imports of the products produced by factors with which they are relatively less endowed(Igberaese & Hague, 2013).

O’Toole (2007) argues that this theory is basis for some countries specialize in producing agricultural and mineral commodities and others produce industrial goods. The theory assumes that there are two countries, two goods and two factors and assumes that both countries have identical technologies, identical tastes, free trade in goods and different factor endowments.

Ohlin and Hecksher (1934) assert that nations with labour abundance should export labour intensive goods and import capital intensive goods whereas nations with capital abundance should export capital intensive goods and import labour intensive goods. The neoclassical economists opine that this process encourages the efficient use of available resources that make trade more profitable among nations.

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Kemp and Van Long (1984) extends the Ohlin and Hecksher model by running three hypothetical situations. One, about the goods produced with exhaustible resources, two about the goods with a single exhaustible and a single non-exhaustble resources. While the third situation involves production of goods produce with two exhaustible and one non-exhaustible resources. They discovered the nations with endowed natural resuorces would more gain. If specializes in goods where it has comparative advantage. This situations facilitate today's international trade.

ECONOMIC INSTITUTIONS AS ENDOGENOUS GROWTH FACTOR

The notion that the pattern and manner human beings organize their environment and societies go a long way to show if such society will be prosper or not. A society that stimulate the citizens to innovate, to save for future, dare to take risks, to research on better way to do things, to learn and educate future generations, to solve problems collectively and also provide public goods in a cost effective manner will certainly prosper (Acemoglu, Johnson, & Robinson, 2005a; Acemoglu, 2000).

Economic institutions is a pivotal upon which economic prosperity and progress revolve. This was propounded by Adam Smith thought on mercantilism and the role of markets which was extended by the work of John Stuart Mill. They agree that if a country has a good economic institutions, the economic growth and prosperity will be guaranteed. They listed following as yardsticks for any successful economy:

1. Existence of equality of opportunity in society
2. Existence of equality before the law

These would facilitate citizens to take the advantage of investment opportunities and as well have security of their investment. According to Acemoglu (2000) such economic institutions are commonly found in market economies.

Among the importance of good economic institutions where the property rights and the perfect market exist include economic incentives to invest both in human and physical capital and as well incentive to invest in research and innovation to advance efficient use of resources. It also would help to allocate and distribute available resources in most efficient manner that would guarantee revenue for firms and enough rent for the government. The problems with lack of market system in an economy include inability to exploit gains of trade and exchange to increase choice and misallocation of natural endowment. The efficient allocation of resources, research and innovation, increased factor allocation are products of effective economic institutions in a market society.

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Generally, economic growth and prosperity in spite of its power to sharpen incentives and influence efficient organization of production system, cultural and geographical factors are of essence. However, economic institution is a major cause of countries economic growth and prosperity differences. This is evident among Organization of Petroleum Exporting Countries (OPEC) as shown in figure 2 below. For instance United Arab Emirate and Nigeria earn income from the export oil and gas but there is wide gap in economic growth and per capita income. While the UAE is among the richest economies of the world, Nigeria is ranked among the poorest. Norway exports less crude oil than Saudi Arabia but because of effective institutions Norway has a more stable and prosperous economy than Saudi Arabia (see figure 2).

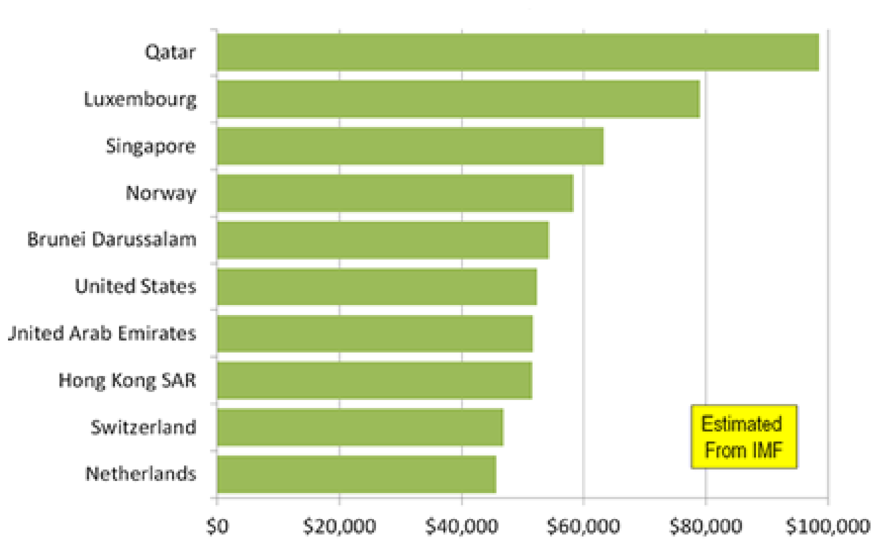

Figure 1: Highest Gross Domestic Product Countries 2010
Source: IMF

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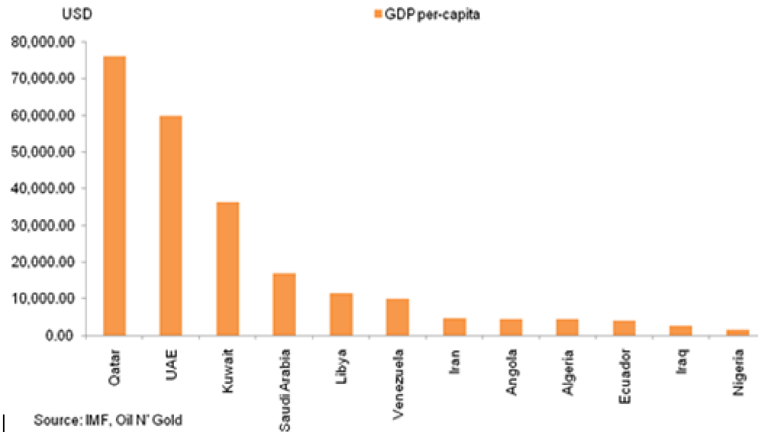

Figure 2: Gross domestic Product per capita of OPEC members 2011
Source: IMF

Economic institutions not only offer more outcomes than economic growth but also a rancor free and efficient allocation of available resources. They help the economy to generate more revenue and rent as well offer better way to share the revenue and rent among the economic agents in the society.

The import of these ideas is diagrammatically illustrated as thus (where the subscript "t" represent current period and represent the future t+1):

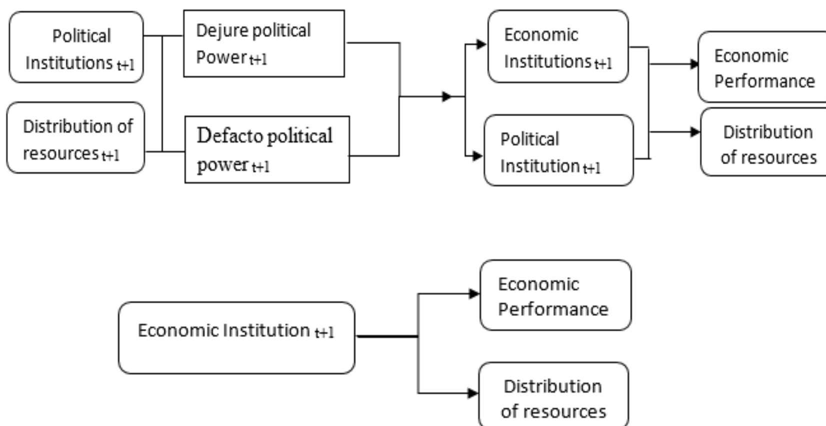

Figure 3: Institution framework
Source: (Acemoglu et al., 2005a)

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The figure above describes two levels of variables which are political institutions and distribution of resources. The distribution of resources influences the distribution of de facto political power at current time (t) while the political institutions determines the distribution of de jure political power at current time (t). It shows the choice of economic institutions and the future evolution of political institutions by the political power (Acemoglu et al., 2005a). However, at time (t+1) it is the economic institutions that will be determined the economic outcomes such as aggregate growth rate of economy and the distribution of resources. In addition the effectiveness of economic institution is endogenous it is determined within the society. All in all, economic institutions determine the economic performance and how well the gains from the resources would be distributed among the people in a country.

CHALLENGES OF ECONOMIC INSTITUTION IN NIGERIA

Evidence suggests that absence of economic institutions that would enforce “rule of the game” is among the most important factors for responsible for inability of the government to use the economic gains for the benefit of Nigerians. From Acemoglu, Johnson, and Robinson (2005b) point out factors that are responsible for some economies to lag behind in spite of rich resources. They mention hold up factor, political losers and economic losers as outcome of institutional failure which is evident in the Nigeria economy.

Hold-up is a situation where the political power holders cannot secure the incomes and assets belonging to the state. In Nigeria, the agitation for resource control, militancy, kidnapping of expatriates and land grabbers activities have crippled property right and drive for investment. The inability of government to enforce the law and guarantee the return on investment is an example of failure of economic institutions.

A situation where economic institutions do not have the capability to protect the broad cross-section of the society but few. In Nigeria for instance, the political power is in the hand of relatively few who use it to protect their own investment opportunities, it is expected that there would be favouritism and lack of transparency. The sharing of oil blocks and the spilling of chemical on the economic livelihood of people while the authority feel unconcerned has created untold hardship in the midst of plenty among people. (Acemoglu, 2000) concludes that the situation would be worsen if the opposition or people outside the political power structure are given less protection in the economy.

Another scenario is when the large percentage of rent is accrued to the power holders from the state resources, this would encourage corruption

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and deprivation of the large percentage of people. Expropriation of others will be possible when economic institutions can be manipulated to serve the rich interest.

In Africa, many institutional reforms are not usually continued by the incumbent especially if adequate legislation was not provided by the political loser before leaving the power. A case in study is public private partnership initiatives in Lagos State Nigeria where opposition promised to quash if elected to power.

In summary, this study uses the global competitive index corroborate the fact that Nigeria situation is an example of the institutions. Economic institutions have failed to deliver economic growth and prosperity over the years even with over thirty-six natural resources found in commercial quantity.

The GCI measures the capacity of the Nigeria economic institutions using twenty-one indicators ranging from property right to investor protection.

Table 1: The Nigeria Global Competiveness Index (GCI)

Year	**Country count**	**Rank**	**Score**	**Effort**
2006-2007	121	87	3.33	28%
2007-2008	131	103	3.33	21%
2008-2009	134	106	3.42	21%
2009-2010	133	102	3.34	23%
2010-2011	139	121	3.18	13%
2011-2012	142	111	3.31	22%
2012-2013	144	117	3.33	19%

Source: World Economic Forum

The table above illustrates a continuous worsening situation of Nigeria's institutional systems having the best outing in 2006. Among 182 countries examined, Nigeria is ranked 144 a score value of 3.33. This further shows that Nigeria would not be able to use the endowed wealth to create better lives for the people.

CONCLUSION AND RECOMMENDATION

From the above, the study has been able to explain the reasons for diverging experiences in economies with abundance resources and potentialities to achieve greatness. The difference between the growth winners and the growth losers as described by Mehlum, Moene, and Torvik (2006) is institutional arrangements. Nigeria like any other

resource rich economies gained a lot of income and rent from the sales of these resources, however, its economy has been ranked as poor.

This study has been able to identify reasons for the difference in economic advancement of countries despite resource abundance. It also shown that not only institutions that explain the economic growth and progress but geography, culture and commitment of the people are inclusive. However, good economic institution has higher probability to define whether an economy would advance or retard. A reasonable approach to tackle this issue is for the political power to start institutional reforms without delay. This study believes that the Nigerian situation can be made better within few years if economic institutions are made to perform efficiently without hindrance and appropriate legislation to support.

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