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Institutional Determinants of Economic Growth in Ecowas Sub-Region

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ABSTRACT

Following neoclassical growth model, people became deeply interested in the factors that lead to economic growth, characterized by diminishing marginal returns, exogenously determined technical progress and substitutability between the factors of production, namely capital and labour. The new or endogenous growth theory enunciated different sets of factors for economic growth as human capital and innovation capacity. New wave of empiricists with the use of cross-sectional and panel econometrics identified the determinants of economic growth with better precision and confidence. The study is aimed at finding the institutional determinants of economic growth in ECOWAS countries. The panel data analysis - using data collected from Quality of Governance (1946–2012) - suggests that countries are heterogeneous, controls for heterogeneity and collinearity, from whose result shows that for all the countries studied, institutions matter for growth except for political stability. It is also evident from the results that the institutions matter for economic growth, while integration does not among ECOWAS Economies.

Keywords: Corruption, Governance, Institutional Reforms, Growth Per Capita, Property Rights

JEL Classifications: D02, E02, O43

1. INTRODUCTION

One of the major advances in economic research has been to find the reasons or factors that lead to economic growth of countries. What causes nations to grow has been discussed extensively in economic literature, even as far as Adam Smith's "Nature and Causes of Wealth of Nations." Economic theories have also shown at different periods, when some countries grow, others slack. This has given rise to an area of study of development economics and economic globalisation. The reasons for spatial of discrepancies in the rate nations' growth has led many great economists into propounding theories of economic growth. These growth theories enunciate different factors ranging from the classical to the neoclassical and then to the new growth ones.

One of the major findings from the theory of economic growth is the division of the growth factors into the traditional factors, which Brodzicki and Ciolek (2008) called the shallow factors, and what they called the deep factors. According to them, the shallow determinants of economic growth emanate from the classical growth accounting theory which involves the accumulation of

both the physical and human capital, in addition to the residual, called the total factor productivity (TFP). To them, these factors are endogenous in nature. A critical look at the neo-classical theory by Solow (1956) and Swan (1956) tows this line. Some empirical studies on economic growth factors, Helpman (2004), Hulten and Isaksson (2007), observed that most of the discrepancies in the growth rates of economies are related to the impact of this residual -TFP. Brodzicki and Ciolek (2008) felt unsatisfied with results emanating the studies on TFP because to them these factors could not explain the true nature of the residual element. They had to enquire into the second aspects of factors that determine rate of economic growth which they called the deep determinants.

It should be noted that most of the empirical studies that maintained the self-sustaining and convergence analysis towed the line of this first determinants of economic growth rates of countries. Even part of the new (endogenous) growth theory accepted the idea that physical and human capital accumulation generated faster rate of economic growth in many countries. However, Rodrik (2002) points that emphasis should shift from the traditional analysis of the shallow determinants to the analysis

of principal, deep determinants, which he listed as geography, integration (trade openness) and institutions. According to Rodrik as cited in Brodzicki and Ciolek (2008), geography involves the set of factors related to earth and is the only purely exogenous determinant of growth. They went on to explain institutions and integration to be semi-endogenous in nature which are also affected by geography. There have been serious contentions and arguments by researchers on the significance or otherwise of particular determinants, especially as some studies point to the fundamental fact that geography is exogenous and is outside the realm of economic policy interventions.

Rodrik (2002), in a bid to unravel the deep determinants of economic growth argued that the impact of institutions is far larger than that of geography. According to him, institutions refer to the quality of formal and informal socio-political arrangements - ranging from the legal system to broader political institutions—that play an important role in promoting or hindering economic performance (Rodrik, 2002. p. 5).

However, Dandume (2013) studied “Institution and Economic Growth Performance in Nigeria” using Auto-Distributed Lag Co-integrated causality models. He found that there is bifocal causality relationship between institution and economic growth. Iyoboyi and Latifah (2013) investigated the impact of institutional capacity on the macroeconomic performance of Nigeria from 1961 to 2011. They employed multivariate vector error-correction model and found that there exists a co-integration relationship between institutional capacity, fiscal-monetary policy mix and macroeconomic performance. The results of the impulse response function showed that that the standard deviation innovation in institutional changes reduces the macroeconomic performance, and that the variance decomposition tests carried out indicate that variations in the macroeconomic performance do not emanate from the changes in institutional capacity.

Nigeria and other ECOWAS member countries (ECOWAS means Economic Community of West African States) have over the years been struggling to build and maintain a high sustainable economic growth. The institutional structures in these countries have been such that do not effectively and efficiently produce the desired outcome. The rule of law has been undermined, checks and balances not effective, security of life and property in disarray, and bureaucratic bottlenecks became instituted, and rent-seekers took over the economic field. Consequently, the activities of institutions can affect growth and development in different ways including their effects on how the markets function, the competitive nature of the economy, socio-economic policies, rule of law, business environment, security, investment, among others. This is because various political and legal agents and other institutional agents (including executive, legislature and judiciary) who should usually act as restraints on the public are very weak and ineffective; and this has an untold consequence on the economic performance. In spite of the efforts through policies, agencies and commissions, the ECOWAS economies are still heavily counted as one of the poorest countries on the globe, irrespective of her endowment of both human and natural resources. It is then imperative to look inwards and ask the question which Rodrik (2002), Rodrik et al.

(2002), Lal (1998), etc, asked in their various studies. Since this study is limited to ECOWAS countries, it deviates from Rodrik (2002) by removing one the deep determinants of economic growth – geography – bearing in mind that these countries have similar geographical contiguity.

2. LITERATURE REVIEW

The starting point of conventional economic growth theory is the neoclassical model of Solow (1956). The basic tenets of the model include: Constant returns to scale, diminishing marginal productivity of capital, exogenously determined technical progress and substitutability between factors (capital and labour).

Political institutions determine the type of leadership system that a country witnesses. The quality of political institutions is widely held to be one of the most important determinants of the quality of economic institutions (Adserà et al., 2003). Political competition and the checks and balances imposed in a well-functioning democracy restrict the ability of governments to engage in rent seeking (North, 1990), while the accountability of government to taxpayers leads to more business-friendly rules and regulations Olson (2000), and North and Weingast (1989).

Institutions that provide dependable property rights, manage conflict, maintain law and order, and align economic incentives with social costs and benefits are the foundation of long-term growth.

The link between the quality of economic and political institutions is further reinforced as better economic institutions tend to support economic development, and economic development over time may lead to demand for better political institutions (Lehne et al., 2014). In fact, disentangling the direction of causality (from democratisation to better economic institutions and vice versa) is a difficult task, not least because common factors such as history and geography may affect both (Lehne et al., 2014).

A country’s geography can have great impact on a country’s economic development. For instance, Gallup et al. (1999) show that landlocked countries with difficult climates and terrains may experience lower growth and development outcomes due to high transportation costs, diseases, low productivity in agriculture and other factors; others argue that geography affects development primarily through its impact on economic and political institutions (Robinson et al., 2005). The quality and quantity of natural resources depends on geography. Geography and climate also determine welfare such as the public-health environment – the citizens’ exposure and vulnerability to diseases – and the quantity and quality of human capital (Rodrik, 2002). He also expanded this by explaining that geography influences an economy in two ways, namely, the extent to which a country can become integrated with world markets, regardless of the country’s own trade policies; and geography shapes institutions in a number of ways.

Characteristics of the terrain may also matter, both for economic outcomes directly and for the quality of institutions. In particular,

costs of trade and investment are likely to be higher in landlocked countries and countries with more difficult, rugged terrain. Being landlocked or having more difficult terrain increases the cost of trade and investment. At the same time, difficult conditions may encourage the development of economic institutions that aim to compensate for higher transaction costs (Nunn and Puga, 2012).

Acemoglu et al. (2001) further argue that colonial institutions were weaker in countries where mortality among colonial settlers was higher. This was because colonisers had little incentive to build “inclusive” economic and political institutions such as property rights and democratic government that support long-term investment and every incentive to extract (appropriate) rents available in the short term.

As institutions take a long time to mature (history of self determination), the length of time that a country has been an independent state may also play an important role. Countries with a longer history of self-governance as a state are likely to have more developed economic institutions (Chanda and Putterman, 2007). The history of self-governance can be summarised in an index that measures the effective length of independent statehood of each country.

A country’s specific feature that can affect the success of reforms and institution building is the extent of ethnic fractionalization along ethnic or linguistic lines (Alesina et al., 1999). In divided societies it may be more difficult for different ethnic groups or political parties to agree on the direction of reforms that are needed to strengthen a country’s economic institutions (Lehne et al., 2014). One of the pioneering researcher on detrimental impact of ethnic diversity were Easterly and Levine (1997), who argue that the public policy choices in ethnically fragmented societies are not economically optimal due to the conflict of preferences. The leading rationale is that in heterogeneous societies, there is a greater likelihood for competition among interest (ethnic) groups for the provision of public goods, leading to poor public policy decisions (Alesina and Tabellini, 1989). Several studies have been undertaken to buttress this significant impact of ethnic diversity on economic performance on nations, especially as it affects the public policy and poor provision of infrastructure and other public goods (e.g. Alesina and Drazen, 1991; Shleifer and Vishny, 1993; Alesina and Rodrik, 1994; Alesina and Spoloare, 1997; Collier, 2000).

Openness of the economy to international trade and investment is also likely to affect evolution of a country’s economic institutions. This is because foreign investors may create stronger demand for better institutions. The presence of multinational companies do often facilitate the transfer of skills and the adoption of international business practices, which, over time, lead to improvements in some economic institutions (Foley, 2002). Dual listing of company shares contributes to improved corporate governance (Coffee, 2002). The presence of education and training abroad also play a key role in strengthening the technical capacity of the government, civil service and state-owned companies, if they employ many of the returning scholars. This may help to design and implement technocratic economic reforms.

3. DATA AND METHODOLOGY

3.1. Description of Data

This study used annual panel data for the period 1946–2012 obtained from the Quality of Governance data (QoG). The panel data analysis suggests that countries that are heterogeneous, controls for heterogeneity and collinearity, gives more data point, brings more variability, gives more degrees of freedom, increases efficiency, allows study of speeds of adjustment to policy changes, allows us to discover and quantify the effects that may be detected using time series or cross-sectional data.

3.2. Description of Variables

Openness to trade (TOP) is defined as the total trade (exports plus imports) as a percentage of GDP in constant prices, with a reference year of 2005. The value of GDP per capita is derived by adding up consumption, investment, government purchases and exports less imports, and dividing by the population. Index of Democratisation combines two basic dimensions of democracy - competition and participation – measured as the percentage of votes not cast for the largest party (Competition) times the percentage of the population who actually voted in the election (Participation). The product is divided by 100 to form an index that, in principle, could vary from zero (no democracy) to 100 (full democracy). Empirically, the largest value is seen to be 49.

Political Stability combines several indicators which measure perceptions of the likelihood that the government in power will be overthrown by possibly unconstitutional and/or violent means, including violence and terrorism.

Rule of Law includes several indicators which measure the extent to which agents have confidence in and abide by the rules of the society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts. Together these indicators measure the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social cohesion and interaction and the extent to which property rights are protected.

Control of Corruption is an indicator that measures perception of corruption, conventionally defined as the exercise of public power for the private gain. The particular aspect of corruption ranges from the frequency of “additional payments to get things done”, to the effects of corruption on the business environment, to measuring “grand corruption” in the political arena or in the tendency of the elite group to engage in “state capture”. Government share of GDP is the share of government spending as a percentage of GDP; GDP Growth is the growth rate of GDP at constant prices, in percent.

4. ANALYSIS OF RESEARCH FINDINGS

In this section we perform a panel analysis on the data set. We used the data set for the member countries of Economic Community of West African States (ECOWAS). This is a regional economic union made up of 16 countries in West Africa, namely, Benin, Burkina Faso, Cape Verde, Cote d’Ivoire, Gambia, Ghana, Guinea, Guinea

Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo. Out of these 16 countries, data for Mali and Mauritania were not available from the QoG data set; we therefore used the data for 14 member States of ECOWAS. Table 1 reports the results for the panel regression for the 14 member Countries of ECOWAS.

From Table 1, it is evident that degree of trade openness has a negative sign, showing that the more open the member States open their borders for trade to flow among one another, the less growth per capita they observe in their economies. This might be true because in this economic union, there free flow of both goods and services, and human capital across all the member nations, with the incipient and concomitant loss of revenues (from taxes) accruable to these countries. Trade openness is also not a significant motivator for economic growth among these countries. Again, most of the member states prefer to trade with advanced countries, and the fast-growing Asian countries where they buy varieties of goods and services at even cheaper rates than among themselves. It could also be that all the member states produce and trade in primary products whose prices are demand-determined, and which also yield low income compared with manufactured counterparts.

The index of Democratisation which shows the degree of competition and participation in politics has a positive and significant (at 1%, 5%, and 10% respectively) relationship with economic growth per capita in the ECOWAS sub-region. In similar way, Control of Corruption, and Rule of Law are statistically contributors to economic growth in the region, and show statistical significance at 1%, 5%, and 10% respectively, whereas the Share of Government is significant at 1% level. The implication this finding is that democracy, rule of law and the degree at which corruption is controlled are important determinants of economic growth among the countries in the sub-region.

However, Political Stability has a negative relationship with economic growth among these countries. This seems true due to incessant and continual coups and counter coups, civil disturbances, riots and violent killings in the sub-region. Some few years ago, Liberia, Sierra Leone, Cote d'Ivoire and Mali had one crisis or the other, and just some weeks or months ago, it was Burkina Faso. It implies that there has been political instability

in the ECOWAS sub-region and the earlier the countries embrace democratic governance the better and more growth they witness.

5. CONCLUSION

The findings of this research have shown that openness to trade among the member countries is at variance and not consistent with the position of Foley (2002) that openness to international trade and investment is likely to be affected by the evolution of a country's economic institutions. But in the case of ECOWAS sub-region, openness to trade among them is not an important factor to economic growth in the sub-region.

Good political and economic institutions help countries to move out of poverty and embrace growth and development. This is in line with our findings that index of democracy, control of corruption and rule of law lay credence and support economic growth and development. This is also consistent with the finding of Glaeser et al. (2004) that poor countries get out of poverty through good policies, often pursued by dictators, and subsequently improve their political institutions. The findings of this study is also consistent with the research of Acemoglu et al. (2001) who put forward a strong argument in favour of the proposition that institutional quality is the fundamental determinant of economic growth and development. This study also supports the findings of Rodrik et al. (2002) and Easterly and Levine (2003) on the superiority of institutions over openness to trade and integration in their effects on economic growth.

Political instability has ravaged the sub-region and has undermined economic progress over the years. It can be seen from our results that political instability has a negative influence on the growth rate of economies of the region, thus significantly undermining the growth process. Political instability scuttles the rule of and undermines the constitutional proceedings, jettisons the judicial process, creates unhealthy environment for business, insecurity and uncertainty.

From the above analysis, we therefore recommend the following:

- i. The ECOWAS member countries should review their trade policies so as to entrench policies that would bring positive benefits from integration in the region.
- ii. In order to ensure economic progress, political stability should be consolidated through the process of democratization, which

Table 1: Panel regression results of GDP growth per capita for the 14 ECOWAS member states

| Variables | Coefficient | Standard error | t-statistic | P-value | 95% confidence interval |
|--------------------|--------------|----------------|-------------|---------|-------------------------|
| Constant | 1484.115*** | 130.7925 | 11.35 | 0.000 | 1225.813–1742.418 |
| TOP | -2.659468 | 1.42437 | -1.87 | 0.064 | -5.472459–0.153522 |
| Index dem | 33.79956*** | 7.271646 | 4.65 | 0.000 | 19.43877–48.16034 |
| Govt/GDP | 1.832737** | 0.5664897 | 3.24 | 0.001 | 0.7139756–2.951498 |
| Contr corrupt | 572.533*** | 125.1736 | 4.57 | 0.000 | 325.3275–819.7385 |
| Polit Stab. | -268.2472*** | 70.18379 | 3.82 | 0.000 | -406.8533–129.6412 |
| Rule Law | 511.1052*** | 132.272 | 3.86 | 0.000 | 249.8809–772.3295 |
| Observations | 167 | | | | |
| R-squared | 0.5547 | | | | |
| Adjusted R-squared | 0.5380 | | | | |
| F (6, 160) | 33.22 | | | | |
| Prob>F | 0.0000 | | | | |
| Root MSE | 439.1 | | | | |

* $P < 0.05$, ** $P < 0.01$, *** $P < 0.001$. Source: Regression output from stata 13

- would engender smooth transition from one regime to another. Democracy would enshrine rule of law, political stability, reduce corruption, rent seeking behavior, etc.
- iii. The ECOWAS member nations should rise to the challenge of adopting institutional policies which spur economic growth of the sub-region; such institutional policies include removal of bottlenecks in the bureaucracy, instituting anti-corruption agencies, etc.
- iv. In conclusion, since the findings in the ECOWAS economies showed that institutions mattered for growth, there is need to improve on the existing institutions in this region. Then the region needs to design policy that would enable these institutional reforms and reap the benefits there from.

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APPENDIX

| pwt_rgdpch | Coefficient | Std. Error | t-statistic | P-value | 95% Confidence Interval | |
|------------|--------------|------------|-------------|---------|-------------------------|-----------|
| pwt_openk | -2.659468 | 1.42437 | -1.87 | 0.064 | -5.472459 | 0.1535222 |
| van_index | 33.79956*** | 7.271646 | 4.65 | 0.000 | 19.43877 | 48.16034 |
| pwt_gsg | 1.832737** | 0.5664897 | 3.24 | 0.001 | 0.7139756 | 2.951498 |
| wbgi_cce | 572.533*** | 125.1736 | 4.57 | 0.000 | 325.3275 | 819.7385 |
| wbgi_pse | -268.2472*** | 70.18379 | -3.82 | 0.000 | -406.8533 | -129.6412 |
| wbgi_rle | 511.1052*** | 132.272 | 3.86 | 0.000 | 249.8809 | 772.3295 |
| -cons | 1484.115*** | 130.7925 | 11.35 | 0.000 | 1225.813 | 1742.418 |

| Results of the panel regression analysis | |
|--|--------|
| Observations | 167 |
| R-squared | 0.5547 |
| Adjusted R-squared | 0.5380 |
| F (6, 160) | 33.22 |
| Prob>F | 0.0000 |
| Root MSE | 439.1 |

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