Global Journal of Management and Business Research
Volume 12 Issue 13 Version 1.0 Year 2012
Type: Double Blind Peer Reviewed International Research Journal
Publisher: Global Journals Inc. (USA)
Online ISSN: 2249-4588 & Print ISSN: 0975-5853

Cost of Governance on Economic Development in Nigeria

By Stephen Ejuvbekpokpo
Delta State University, Abraka, Nigeria.

Abstract - The study aims at investigating the impact of cost of governance on economic development in Nigeria. Cost of governance is captured by recurrent and capital administrative expenditures, while gross domestic product is used as a proxy for economic growth. Using data from 1970 to 2010 and the Ordinary Least Squares (OLS) technique of analysis, the study reveals that cost of governance hampers economic development in Nigeria. Therefore, there is the need to place institutional constraints on public office holders and technocrats in order to minimize the extraction of rent from the state and enhance the availability of public funds for development projects and vital sectors of the economy.

Keywords : *Nigeria, weak Institutions, Economic Development, Governance.*

GJMBR-B Classification : *FOR Code: 150303 JEL Code: P46*

COST OFGOVERNANCEONECONOMICDEVELOPMENTINNIGERIA

Strictly as per the compliance and regulations of:

Cost of Governance on Economic Development in Nigeria

Stephen Ejuvbekpokpo

Abstract - The study aims at investigating the impact of cost of governance on economic development in Nigeria. Cost of governance is captured by recurrent and capital administrative expenditures, while gross domestic product is used as a proxy for economic growth. Using data from 1970 to 2010 and the Ordinary Least Squares (OLS) technique of analysis, the study reveals that cost of governance hampers economic development in Nigeria. Therefore, there is the need to place institutional constraints on public office holders and technocrats in order to minimize the extraction of rent from the state and enhance the availability of public funds for development projects and vital sectors of the economy.

Keywords : Nigeria, weak Institutions, Economic Development, Governance.

I. Introduction

The prosperity of any nation hinges on efficient government. The government helps to sustain the social contract that binds every member of the state. Thus, the price that is paid for a state to be prosperous is for it to have an established government that enforces the social contract. Members of an ordered society, called a state, must pay taxes sufficient to carry out the functions assigned to the state.

In Nigeria, costs associated with the running of the government have increased dramatically over the years such that an increasingly reduced proportion of public revenue is available to support and implement the primary functions of government (CBN, 2005). Consequently, the major purposes of government have been hindered.

A point of departure is to consider how the federal Government budget is divided strictly between recurrent and capital expenditures while recurrent expenditure as a percentage of total government expenditure was 79.22% at the beginning of the 1970s, it has declined to 43.03% by the end of the 1970s. IT rose to 49.30 by the end of the second Republic in 1983, further rising to 63.36% by the end of the 1980s. The dramatic rise in export earnings due to the oil boom of the 1970s resulted in a reduction in the proportion of the budget allocated to recurrent expenditure.

Correspondingly, the drastic fall in the price of crude oil in the early 1980s equally raised the proportion of the budget apportioned to recurrent expenditure. Though there was a decline in the proportion of the budget allocated to recurrent expenditure, from 60.10% in 1990 to 36.56% in 1998, it has since risen to 80.29% in 2003. The justification for using recurrent expenditure as a percentage of total budget as an important indicator of the cost of governance stems from the belief that capital expenditure impacts more positively on the economy in respect to employment, investment and other growth-inducing activities (Adewole and Osabuohien, 2007).

Total administrative expenditure as a percentage of gross domestic product (GDP) was a high as 8.72% in 1977 but fell to an all time low of 2.04% in 2002. According to Adewole and Osabuohien (2007), if we assumed that government administrative expenditure supports the GDP of any given society, then an administrative expenditure of nearly 9 kobo went into the production of N1 worth of goods and services for the period of 1977 to 2002.

Over the subsequent years, the administrative costs of producing N1 worth of goods and services fell to 2 kobo in 1989. It rose to 4 kobo in 1999 and then to 7 kobo in 2002. According to Haber (2004), much of the high costs of governance are largely due to the absence of institutional structures that direct attention away from predation to production. When the primary function of the state is essentially redistributive or predatory, productive activities become less significant as a driving force of economic activities. It is against this background that this empirical work is motivated to analyze the effects of the continuous rise in costs of governance on economic development in Nigeria.

II. Literature Review

a) The Cost of Governance

The cost of governance is the money spend on administrative processes. It is also known as administrative expenditure. Adewole and Osabuohien (2007) decomposed cost of governance into two: recurrent administrative expenses and capital administrative expenses. They defined cost of governance as costs associated with the running of government. In other words, these are costs incurred by the government is running this affairs. The government helps to sustain the social contract that binds every member of the state.

Similarly, Fluvian (2006) defined cost of governance as any expenditure in maintaining government administrative structures. He also equates cost of governance to total administrative expenditure,

Author : Economics Department, Delta State University, Abraka, Nigeria. E-mail : ejirosteve2@yahoo.com

which is a part of total federal government expenditure in Nigeria. He said that the justification for using total administrative expenditure as cost of governance stems from the fact that administrative expenditures are incurred in governing processes.

According to Drucker (2007), cost of governance is government budget allocated to both capital and recurrent expenditures on maintaining government administrative structures, which appears to be very enormous in Africa the question of efficiency in governance is, therefore, to ensure that public funds are spent judiciously, while public goods and services are sufficiently provided.

The distribution of Public goods and services in Nigeria is based on the principle of equity. Natural and human resources may skew income distribution in favour of endowed groups when the market is allowed to be the principal mechanism for resource allocation. Free markets are, therefore, more likely to be hindered when pronounced disparities exist in the distribution of natural and human capital endowments among groups that exist in a particular society. This mostly explains why the nationalists of northern extraction did not agree at first with the idea of independence in Nigeria, since their limited investment in human capital would put them at a disadvantage in a post - independent Nigeria (Adewole and Osabudien, 2007).

Nigeria, therefore, put up a political arrangement that ensured that the commanding heights of the economy were left in the domain of the public sector. With the benefit of hind sight, one could say this arrangement signaled the beginning of patronize activities that stifled the market and productivity, promoted rent seeking, brought an imbalance between efforts and rewards, and raised the cost of governance in Nigeria. Cost of governance, according to Afolugbo (2004), is therefore the cost incurred in running the government. It is the cost of performing political duties, and discharging civil services to the public.

b) Economic Theory of the State and the Cost of Governance

The structure of government inherited at independence is largely a reflection of colonial influence. The colonial powers arbitrarily divided the African continent so that ethnically unrelated peoples were forced into political matrimony for the formation of a state (easterly and Levine, 1997) Colonial governments established "extractive institutions" in places where unfavourable weather had serious health consequences for them and created European style institutions in places favourable for habitation (Afolugbo, et al, 2004).

Thus, weak institutions, amply represented by growth – inhibiting political structures, became the dominate feature of resource rich multi- ethnic societies. Afolugbo, et al (2004) added that the opportunistic behavioiur of ethnic leaders, particularly in a mineral-rich polity such as Nigeria, eventually produced a government structure that had a negative toll on social and economic progress.

According to Iyoha and Oriakhi (2002), a larger than optimal civil service, dominated mainly by that section of the country with significant human capital deficiencies is bound to raise governance costs and institutionalize the mechanisms for rent extraction. This is a major problem in Nigeria.

Another institutional factor that raises cost of governance is the provision of security by the state. For instance, a public good like law and order (security for short) has a high degree of public interest, upon which there is a broad consensus that it could be more cheaply provided by government, particularly by a central government, if we admit that in reality there is no pure public good, we should understand why profit-maximizing firms could equally provide complementary security services.

However, government provides that bulk of security services. Thus, the role of the private sector in the security sector is minimal. We recognize that the different levels of government would be able to organize security effectively. According to Adewole and Osabuohien (2007), the absence of the centralization of security affects its efficiency and drives up cost of making security available.

This model is drawn mainly from the insights provided by Olsen (1965) and Fates, et al (2002). In conventional economic theory, the state is a product of cooperation. In other words, rational human who live within a defined territory discover a net gain in cooperation rather than in competition. It could be likened to a group of many perfectly competitive firms who form a collusive unit called a monopoly.

From a political economy perspective, the state is the by – product of rational individuals who believe that state formation would be better than living as individual or families. The state, therefore, as well as being the government's instrument of operation, is a natural monopoly, for no two organizations with equal powers of force over a defined territory can co-exist successfully and maintain relative peace.

Lastly, the state is formed for the benefit of the people. It enables individuals to co-exist peacefully by avoiding violence and reducing tendency for communal and individual clashes. Fates, et al (2002) added that if people can resist the temptation to steal, or extract rent for selfish reasons, there will be prosperity in the state. However, this is unlike the Nigerian situation. Most politicians are corrupt, selfish and passive. They specialize in looting public treasury. Consequently, pronounced poverty is a key feature of this kind of society. For there to be growth and development, resources must be channeled towards production.

c) The Rising Cost of Governance in Nigeria

Governance represents more than a means of providing common good, as it can be related to the government capacity to help the citizens ability to achieve individual satisfaction and material prosperity. Therefore, governance could be compared to the management, supply and delivery of public services to a nation.

According to Fluvian (2006), there are specific factors responsible for the rising cost of governance in Africa. First, there is the issue of inflation. Public project costs are unduly inflated by corrupt politicians. There should be equity. Adewole and Osaabwohien (2007) added that the rising cost of governance in Nigeria is a price we have to pay for undue consideration for equity.

Similarly, the issue of misuse of public funds is another cause of the rising cost of governance in Nigeria (Warimen, 2007). Political leaders inflate the costs of public projects to embellish themselves. Adewole and Osabuohien (2007) also said that the supply of security beyond the optimal level will lead to limited prosperity. In other words, the excess money spent by government on a particular set goods affects development, since resources are scarce and should be optimally utilized.

Furthermore, there is population increase. An increase in population implies that there is pressure in the limited available the resources. Fluvian (2006) also said that increase in population implies that more demand for public goods and services, such as education, health services, etc. the need to give every ethnic group adequate representation is another reason for increasing cost of governance.

Another major cause of the persistent rise in cost of governance in Africa vis-a – vis Nigeria is the extra large civil service sector. This has been described as an institutional factor by Afolugbo, et al (2004). Most public workers in Africa are redundant due to employment of excessive work staff to reduce unemployment. Employees are more than the optimal size, which led to inefficiency and unnecessary increase in cost.

III. Theoretical Framework

Given the fact that resources are limited, an increase in the cost of governance implies that there will be decrease in available funds for productive purposes. Thus, adequate resources need to be allotted to vital sectors such as agriculture, industry and education. This arrangement exploits the opportunities offered y comparative advantage of costs in governance and costs in production.

Consequently, this study is based on the theory of comparative cost Advantage. To enhance the pace of development, more public funds must be allocated to development projects and there must be reduction in cost of governance. The optimal size of government and the civil service is required for governance to be effective and efficient. According to Olivia (2007), in a nation with government cabinet that is larger than optimal and / or a civil service sector that is extra large, there will be a rising cost of governance.

The theory of comparative cost Advantage is based on opportunity cost analysis. A rising cost of governance will definitely lead to decreasing cost of production or industrialization and public services such as health, education, security, etc. Olivia (2007), therefore, claimed that the opportunity cost of increasing governance is decreasing finance for productive activities.

To enhance growth and development, governance must be cost-effective and the civil service sector must be efficient; and there must be increasing investment of public funds in productive sectors of the economy. The civil service sector must be reduced to manageable but optimal size. In Nigeria, the civil service sector is extra large with gross inefficiency and exorbitant cost to the government.

When a state is constituted properly it is possible for the society to end up with an optimal mix of both public and private goods that will maximize social welfare. For economic efficiency, private goods can be more cheaply provided by private firms and public goods by a collective organization – the government.

At equilibrium, according to Adewole and Osabuohien (2007), output can no longer be increased since both the private and the public sectors produce goods in which they have comparative advantage. Thus, the last naira spent on private goods will raise output by as much as the last naira spent on public goods, in Nigeria however, the private sector is more efficient than the public sector, which is characterized by rising costs.

This foregoing analysis is important because the cost of governance is minimal when each (private and private sectors) is only allowed to do what it can do best. Providentially, the free market imposes adequate discipline on the players in a way that drives them to produce at minimal cost. But where well-defined rules are lacking politicians are not constrained to seek to minimize the cost of governance (or administrative expenditure). This is the Nigerian experience.

IV. Model Specification

A general growth model is specified in the study. Gross domestic product is used as a proxy for economic development; while cost of governance is captured by total administrative expenditure, which is decomposed into recurrent administrative expenditure and capital administrative expenditure. The model can, therefore, be specified thus:

$$GDP = f(REX, CEX) \quad - \quad - \quad - \quad (1)$$

Put in an explicit form, the above model becomes:

$$GDP = \alpha_0 + \alpha_1 REX + \alpha_2 CEX + u_1 \quad - \quad - \quad - \quad (2)$$

Where,

$$\alpha_1 < 0 \text{ and } \alpha_2 < 0$$

According to economic theory expectations, there is an inverse relationship between cost of governance (represented by administrative expenditure) and gross domestic product. An increase in cost of governance reduces the availability of public funds for development projects which invariably hampers growth and development. Thus, an increase in recurrent administrative expenditure (REX) and /or in capital administrative expenditure (CEX) hinders development.

Consequently, increase in costs of governance (or administrative expenditure) has negative impact on gross domestic product.

The model specified in the study, as could be seen above, is a multiple regression model which is more reliable in terms of the estimates of the parameters than a single regression model. Various statistical and econometric tools will be adopted in interpreting the results. These include the coefficient of determination, f-test, t-test and Durbin-Watson statistic.

V. Discussion Of Findings

The result obtained from the analysis is presented below:-

GDP	=	2.21 – 0.52REX – 0.45 CEX
Std. Error	=	(0.63) (0.16) (0.20)
t-stat	=	[3.48] [-3.31] [-2.24]
R- Squared	=	0.93
F – stat.	=	259.73
Dw – stat.	=	2.01

From the above result, a unit rise in recurrent administrative expenditure will lead to 0.52 unit fall in gross domestic product; while a unit rise in capital administrative expenditure will cause gross domestic product to fall by 0.45 unit. This is in line with the theoretical expectations, both recurrent and capital administrative expenditures have negative impact on gross domestic product.

The t–statistic of recurrent administrative expenditure in absolute terms (3.31) is greater than the t-critical value (2.02), at the 5% level of significance. This indicates that recurrent administrative expenditure is statistically significant in explaining changes in gross domestic product in Nigeria. Similarly, the t- statistic for capital administrative expenditure in absolute terms (2.24), at the 5% level of significance, is greater than the t-critical value (2.02), which also indicates that capital administrative expenditure is statistically significant in changes in gross domestic product in Nigeria.

The coefficient of determination (0.93) indicates that 93% of the variations in gross domestic product is explained by both recurrent and capital expenditure. In other words, 93% of the variations in gross domestic product is caused by cost of governance. The F-statistic (259.73) is greater than the f-critical value (3.23), at the 5% level of significance. This implies that both recurrent and capital administrative expenditures are statistically significant in explaining changes in gross domestic product. This also indicates that the overall fitness of the model is good.

The Dw-statistic (2.01) is approximately 2.00, using the rule of thumb. This implies that there is absence of first order serial correlation (or autocorrelation) in the model.

VI. Conclusion And Recommendations

Some findings are made from the results presented and interpreted above.

First, the study reveals that cost of governance (represented by both recurrent and capital administrative expenditure) has a negative impact on gross domestic product in Nigeria. An increase in cost of governance implies that there is decrease in government expenditure on public projects in vital sectors of the economy. This is because resources are scarce. An increase in expenditure on administration reduces expenditure on development projects, which adversely affect growth and development.

Second, the increase in cost of governance indicates that there is high level of corruption and inefficiency, which make available funds barely sufficient to finance projects in agricultural and manufacturing sectors. Consequently, an increase in cost of governance, represented by administrative expenditures, has a significant impact on gross domestic product.

In the absence of strong political institutions, the reduced cost of governance could only be achieved if a benevolent set of public officer is in power. Since that is highly unlikely, there is every need to draw some vital conclusions which will guide policy making.

The cost of governance in Nigeria has a negative but significant impact on gross domestic product in Nigeria. A rise in the level of governance cost hampers the pace of economic growth and development in the country. The rising cost of governance reduces the availability of public funds for development projects.

In order to reduce cost of governance, there is the need to place institutional constraints on public office holders and technocrats in a way that minimizes the extraction of rent from the state. This is the better path to follow if the cost of governance is to be drastically reduced in Nigeria.

Also, Public funds should be judiciously utilized. In other words, every naira of public funds showed be spent to maximize social welfare. A huge proportion of government revenue should be expended on development projects and in vital sectors of the economy, such as agricultural and manufacturing sectors.

The Nigerian legal system should be overhauled to achieve efficient dispensation of justice. This will help to reduce corrupt practices, such as inflation of costs of public projects, "kick-backs" before contracts are awarded, abandoning of public projects, etc. also, property rights should be well defined to ensure the smooth operation of the free market system.

There should be an optimal cabinet size to reduce cost of governance. The larger than optimal size of the executive cabinet and civil service sector are major causes of increasing cost of governance in Nigeria. It has also led to inefficiency in the public sector and waste of public fund.

References Références Referencias

1. Adewole, A.N. and Osabuohien, E.S.C. (2007) "Analysis of the Cost of Governance and Options for its Reduction in Nigeria". *Nigerian Journal of Economic and Social Studies,* 49(1):137 – 159.
2. Afolugbe, O. et al (2004). "Institutions as the fundamental cause of Rising cost of Governance" American Economic Review, 5:1369 – 1401, December, 2004.
3. Artadi, E. and Sala-i-Martin, X. (2003). The Economic Tragedy of the XXth Century Growth in Africa. NBER Working Paper, W9865, July.
4. Bednar, J.W.N, et al (2009). The Cost of Governance. Working Paper, Standford University.
5. Cebula, R. J., et al (1981)."The Crowding out Effect of Federal Government Outlay Decisions: An Empirical Note". Public Choice, 36 (2):329-336.
6. Central Bank of Nigeria (2005). Statistical Bulletin. Volume 16, December 2005.
7. Drucker, P. (2007). "Governance". Harvard Business Review, 45(2): 82- 98.
8. Emerson, P.M. (2005). Corruption, Competition and Democracy. Working paper, University of Celorado, Denver.
9. Easterly, W and Levine, R. (1997). "Africa's Growth Tragedy: Policies and Ethnic Divisions". Quarterly Journal of Economics, 112 (4): 1203 – 50.
10. Fates, R.H., et al (2002). "Organizing Violence", *Journal of Conflict Resolution* (October).
11. Fluvian, G. (2006). "The Rising Cost of Governance in Africa " *Journal of Public Administration,* 22(9)L 441 – 463.
12. Gramham, J., et al (2003) "Principles for Good Governance in the 21st century". Policy brief, No. 15, Institute on Governance. 99999999933.
13. Haber, S. (2004). Political Competition and Economic Growth: lessons in the political Economy of Banking in Mexico and the United States. Un-published Manuscript, Department of Political Science, Stanford University.
14. Hellriegel, D. and Robert, G. (2001) "Management of cost og Governance in Europe". *Academy of Management Journal,* Vol. 17, No 6, PP, 255 – 280.
15. Ibi-Ajayi, S.I. (2002). Institutions, the missing link in the Growth Process. Presidential Address, Nigeria Economic Society.
16. International Monetary Fund (2005). IMF- Nigeria consultation. Article IV concluding statement. IMF External Relations Department, Abuja. March 8-25.
17. Irma, A. (1999). "The Role of Government in Economic Development" California Agricultural Experiment Station, Working Paper, No. 890.
18. Iyoha, M and Oriakhi, D. (2002). Explaining African Economic Growth Performance: The case of Nigeria. Revised interim Report on Nigeria case study. Prepared for the African Economic research Consortium Research project. Explaining African Economic Growth Performance.
19. Litwin, G.H. and Stringer, R.A. (2008) "Strategies to curb rising cost of governance" Boston: Harvard University, Graduate School fo Economics, P.S.
20. Manning, N., et al (2006)."The Metrics of Trading change in the public sector". The Eleventh International research symposium on public management, Organization for Economic Cooperation and Development.
21. Naylor, C., et al (2000). Cost of Governance in Pre-capitalist Economies. New York: Harper and Row publishers.
22. Nzongola – Ntalaja, G. (2002)> "UNDP Role in promoting Good Governance" Seminar for the international guests at the congress of the labour party of Norway, OSLO.
23. Olivia, R. (2007) "Comparative cost Advantage Analysis of Rising cost of Governance" *The American College,* pp 690 – 750.
24. Olsen, M. (1965). The logic of collective action: public goods and theory of groups. Cambridge: Harvard University Pres.
25. Rotberg, R.I. (2005). "Strengthening Governance: Ranking Countries would help". The Washington Quarterly, 28 (1): 71 – 81.
26. Stefan, E and Janning, J. (2009). "Sustainable Governance indicators". In Bertels – Mann, S. (ed). Policy performance and Executive capacity in the OECD. Gutersloh: verlag Bertelsmann Stiftung.
27. Thomas, A.P. (2006). "The causal Texture of Governance". International review of economics, 12(6): 323 – 394.
28. United Nations Publication (2007). "Public Governance Indicators: A literature Review". Department of Economic and Social Affairs, ST/ESA/PAD/SER.E/100.
29. Warimeh, O.A. (2007), "Contemporary Issues in Good Governance in Nigeria: A proactive Approach: Nigerian Journal of Economic and Social Studies, 49(1): 276–294.

This page is intentionally left blank