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Extractive Institutional Structure and Economic Development: Evidence from Nigeria

Karim Khan[‡]

Abstract

The institutional perspective of cross-country differences in economic outcomes gives contrasting explanations on the persistence of extractive institutions in developing countries. Colonization, social fragmentation and the existence and use of natural resources are the most frequently discussed causes in the available literature. In this study, we analyze all the three explanations together by providing a case study of Nigeria. Nigeria is characterized by colonial legacy, social divide revealed by ethnicity and religion, and huge windfalls from oil. Based on our analysis, we argue that the lack and incoherence of formal institutional order is the main factor for Nigerian underdevelopment. Ethnic politics has shaped the formal institutional framework as a central stage for the disbursement of patronage and other types of the largesse. Colonial legacy has reinforced the effect of ethnicity by failing to provide a national ideology; and instead, providing a regional structure to rule. Similarly, the windfalls from oil have intensified the effect of ethnicity by invoking civil conflicts, arising mainly from the distribution of common pool. Thus, no single factor on its own can explain the persistence of extractive institutions; rather, it is the combination of exogenous and endogenous factors that collectively shape institutions.

JEL Classification: O55, O43, E02, P16, N17, N47

Key Words: Extractive Institutions, Economic Development, Colonization, Social Fragmentation, Natural resources, Nigeria

1. Introduction

The institutional perspective, blossomed recently, proclaim that capital accumulation and technological improvements are only the proximate causes of development. The fundamental determinants that influence capital accumulation and other investment decisions through associated incentives are institutions (North, 1990; Hall and Jones, 1999; Knack and Keefer, 1995; Acemoglu et al., 2001, 2005; Dollar and Krray, 2003; and Rodrik et al., 2004). This school of thought asserts that the selection and persistent of extractive institutions is the main factor responsible for the existence of lower growth performances across the world. Several explanations, in turn, have been provided for the persistence of extractive institutions. For instance, colonization, social fragmentation, and the presence and use of natural resources are the most frequently discussed causes in the available literature.

In this paper we argue that no single factor on its own can explain the persistence of extractive institutions; rather, it is the combination of exogenous and endogenous factors that collectively shape institutions. We exemplify our argument with the case study of Nigeria.

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Our analysis shows that the rent-seeking behavior of interest groups in a society results in the inefficiency of institutional environment which, in turn, has implications for the long run economic outcomes. However, this behavior is shaped by the blend of exogenous factors like colonial legacy and windfalls, and endogenous factors like fragmentation. The approach in this study is different from the earlier work in at least two aspects. First, most of the earlier literature on the issue provides us with a comparative analysis by using cross-country data, thereby ignoring the individual characteristics of economies and the context specificity of institutions.¹ Instead, in this study, Nigeria is an important case for institutional economics due to its three distinguishing features: its colonization experience, its wide-spread social fragmentation, and its enormous natural resources windfalls. This will allow us to remove a large amount of the unobserved heterogeneity (*e.g.* cultural differences across countries) which is often a problem in most of the earlier research on institutions and economic outcomes.²

Second, the aforesaid three features of Nigeria have collectively evolved the Nigerian formal institutional framework. However, the earlier cross-country research takes one of these features at a time and analyzes its implications for the evolution of institutions and economic outcomes. For instance, La Porta et al. (1999), Sokoloff and Engerman (2000) and Acemoglu et al. (2001) explore the influence of colonization on the evolution of institutions, and the consequent economic outcomes. Similarly, Mauro (1995), and Easterly and Levine (2001) show that ethno-linguistic fractionalization is positively associated with poor economic outcomes. Finally, the Natural Resource Curse hypothesis, initiated with the seminal work of Sachs and Warner (1997, 2001), proclaims that the countries with abundant natural resources are more prone to be caught by the famous Dutch Disease.³ Combining these features together, this case study would provide us with the analysis of ‘how each of the three affects the formal institutional framework?’ Also, it would enhance our grasp on how colonization, social divide, and natural resources interact in a single society or how their

¹ According to Hodgson (2006), institutions can be understood within the specific historic, geographical, social context.

² Additionally, case studies collect important contextual factors (historical accidents, local norms, domestic economic structure, etc.) which make for a better understanding of factors influencing institutional and economic development.

³ Dutch Disease is a concept that explains the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector. The mechanism is that an increase in revenues from natural resources will make a given nation's currency stronger compared to that of other nations, resulting in the nation's other exports becoming more expensive for other countries to buy, making the manufacturing sector less competitive.

individual effects reinforce each other? The rest of the paper is organized in four sections. Section 2 describes the theoretical framework of the study. In section 3, we provide the economic, social and institutional background of Nigeria. In section 4, the main arguments of the paper are provided. In particular, we focus on how each of the three features, i.e. colonization or the ruling strategies of the British; social fragmentation; and the abundance of natural resources, have affected the formal institutional framework, and the consequent economic outcomes in Nigeria. Section 5 concludes the paper.

2. Theoretical Framework

Beginning with Hobbes, theorists have emphasized the key role of governmental coercion in preventing predation by private parties. However, it is quite possible that the state may itself be a source of predation. Mill (1848: 70) pointed out the issue in comparing “the protection by the government and protection against the government”.⁴ Alternatively, there is a trade-off between the social losses due to private expropriation (theft, robbery, piracy, war or disorder etc.) or externalities and the social losses due to state expropriations (corruption, rent-seeking etc.)⁵. In particular, the interaction of state with private activities creates incentives for interest groups to control the state in order to accrue the benefits, associated with state intervention (Tullock, 1967; Stigler, 1971; Krueger, 1974; Posner, 1975). Correspondingly, such groups invest resources in rent-seeking activities which, usually, comprise lobbying for influencing government decisions, campaign contributions, voting or controlling the state’s officials. The success of these groups generally is associated with significant costs for the large and poorly organized population or the overall welfare of the society.

Most of the colonized countries are characterized by a kind of social coordination that is called “arbiter-client hierarchy”. During the colonial period, the administration was such that the coordination was secured by a third party akin to Olson’s (1965) *stationary bandit*. The colonizers in the *stationary bandit*, unable to extract rents by themselves, were endowed with a monopoly on coercion. This third party arbiter was empowered to divide the quotas on rents arbitrary at his own discretion; and also, he had the authority to enforce his decisions. Under these conditions, the colonizer was able to extort the rents collected by the other

⁴ He, for instance, argued that the latter is more important because against all other predators there is a hope of defending oneself.

⁵ The details of the Institutional Possibility Frontier are given in the Djankov et al. (2003). In the paper titled as “The New Comparative Economics”, the authors give the possible social orderings for a society ranging from ‘Private Orderings’ to ‘Independent Judges’ to ‘Regulatory State’ to ‘State Ownership’. The authors give a detailed description of the social losses associated with each of these institutional structures.

players or trade some of it for the political loyalty. In such a way, he acted like a landlord that owns the rent sources but allows his agents (clients) to take away some rents as rewards for bringing revenues for him. The agents, in turn, owned clients in the form of private interest groups. The private groups supported the agents in their revenue collecting activities; and, in return, they were endowed with special privileges like monopoly rights, import quotas, or import licenses etc. Thus, colonization provided a basis for the hierarchical structure of arbiter-clients in most of the colonized countries. In such arbiter-clients structures, every senior arbiter coordinates the rent-seeking at his level so that the lower-level arbiters are among his clients. Nigeria is a classic example of arbiter-clients structure where the private interest groups, shaped by ethnicities and languages, are clients to politicians, and the civil and military bureaucrats. The politicians, in turn, are ethnic elites who attract political support from their ethnic community. The local politicians, bureaucrats and the military officials serve the interests of their communities by being clients to the rulers in the federal structure. Given this structure, we would analyze the impact of colonization, social diversity, and windfalls on the Nigerian institutional and economic development.

3. Economic, Social and Institutional Background of Nigeria

Nigeria has the third biggest economy by Gross Domestic Product (GDP) in Africa behind South Africa and Egypt.⁶ It possesses abundant fertile land as well as substantial natural resources in the form of oil. Notwithstanding the abundance of natural resources, Nigeria has been amongst the 15 poorest nations in the World. The economy of Nigeria is highly concentrated in petroleum sector, making large contributions to GDP and foreign exchange earnings. In addition to poor economic outcomes, it is characterized by enormous social problems ranging from mass illiteracy of adult population and gender disparities in education to severe issues like civil conflicts arising from ethno-linguistic and religious fragmentation. Likewise, it is characterized by failed institutions with authoritarian structure since the colonial times.

Nigeria's per capital GDP, in constant 2000 US \$ terms, was on average \$293.48 in the first half of 1960s, and is estimated to have remained at \$365.27 in the 1990s. This is 24.5 percent increase in 40 years, showing a dismal economic performance during the course of the period.⁷ Besides, the growth rate in Nigeria is characterized by volatility. From the

⁶ With a population of 152.22 million people, it is the most populous country in Africa and the 8th most populous in the world.

⁷ See table 1 in the appendix for details.

beginning to the times of oil price hikes, growth rate in per capita GDP was averaging around 2.4 percent. However, it became negative after the sudden slump in oil prices in the first half of 1980s, showing bubbles caused by the windfalls from oil. Similarly, after the failure of Structural Adjustment Program (SAP), the repayment of external debts and severe political instability, the growth rate exhibited to be less than 0.1 percent in 1990s.⁸ Concurrently, in constant 2000 US \$ terms, from 1970 to 2009, Nigeria's cumulative revenues from oil (after deducting the payments to the foreign oil companies) have amounted to about \$480 billion (see table 4 for the details of oil revenue). In 1970, oil revenue per capita was about \$11 that led to \$155.6 in 2000 in constant 2000 US \$ terms, showing almost 1300 percent increase during the period. The only 24.5 percent increase in per capita GDP compared to 1300 percent increase in oil revenues demonstrates that the oil revenues did not seem to add to the standard of living at all. The result is significant amount of poverty with inequality. For instance, based on the definition of population subsisting on less than \$1.25 per day, the poverty rate increased from 36 percent in 1960s to almost 69 percent in 2000.⁹

Likewise, Nigeria is amongst the countries with the lowest life expectancy. Its life expectancy was roughly 40 years in the 1965 but remained at around 50 years in 2010 which is smaller than that of the comparable developing countries. For 2010, with the Human Development Index (HDI) of 0.44, Nigeria is ranked 156th of 187 countries. The time series trends in HDI show that Nigeria has so far been unable to outperform the average development of sub-Saharan countries (UNDP, 2011). The income inequality is higher, and is increasing further overtime. For instance, the Gini index was around 39 percent in the first half of 1980s and it rose to 43.38 percent in 2005. Besides these major indicators, Nigeria is a country with higher infant mortality rates and higher birth rates. The fertility rate of around 6 per woman is higher for a country which is characterized by poor manufacturing base and higher concentration of the economy around natural resources. The public spending on education and health is cumulatively less than 5 percent of GDP. Like growth rate, the public expenditures on social services are volatile. For example, the public spending on education was above 3 percent of GDP at the times of windfalls but it declined to less than 1 percent after the slump in oil prices.

⁸ The Structural Adjustment Programme (SAP) was an economic reform programme, conducted by the international financial institutions like the World Bank and the International Monetary Fund (IMF), with a set of policies centered on devaluation. It originated due to a series of global economic disasters during the late 1970s: the oil crisis, debt crisis, multiple economic depressions and stagflation.

⁹ This translates into an increase in the number of poor from about 19 million in 1970 to a staggering 90 million in 2000 (Sala-i-Martin and Subramanian, 2003).

Politics in Nigeria is based on patronage, clientalism, rent-seeking, and ethnic cooperation (Lewis, 2007). The inability of the state to establish credible commitment, in turn, has vitiated economic policy and undermined capital formation. Nigeria has been under military rule for 30 years out of its 55 years history. Besides its volatile political stability, its history of political succession is threatening. It has experienced six successful coups, numerous failed attempts, and only two abortive democratic regimes in the first 40 years. This centrally illustrates the problems of institutional development in Nigeria.¹⁰ The comparative analysis of the institutional quality indices, summarized in table 3 in the appendix, further enriches this evidence. The indices of the World Bank which estimates various aspects of the governance are divided into six broad categories. The indices, ranging from -2.5 to +2.5, score Nigeria in their lowest ranking. Averaging all the six indicators, Nigeria is scored less than -1 since 1996 to 2008. Thus, based on the definitions of the World Bank, Nigeria is characterized by weak government effectiveness, poor regulatory quality and rule of law, political instability, pervasive corruption and the lack of voice and accountability. Besides World Bank, the Transparency International has persistently rated Nigeria amongst the most corrupt nations in the world. Based on their Corruption Perception Index (CPI), Nigeria was the most corruption nation out of 54 nations in 1996. Similarly, it is categorized as 143rd corrupt country out 182 countries in 2010. In terms of economic freedom, the Heritage Foundation characterizes Nigeria with limited freedom in investment and financial sectors and poor property rights protection. Based on this comparative analysis, we state that corruption, rent-seeking and predatory rule have degenerated the state capabilities and essential institutions. Alternatively, the prevailing institutional framework that has not led to the alleviation of transaction costs has ruinous consequences for long run economic outcomes.

¹⁰ For the detailed political hierarchy, see table 2.

4. Evidence on Colonization, Ethnicity, Windfalls, Institutions and Economic Development

In this section, we explore the interaction between the three features of Nigeria in terms of institutional and economic development. Firstly, we provide separate critical analysis of each of the three features. Onwards, we provide a combined interaction among them for the overall structure of Nigeria.

4.1. Colonial Legacy and Nigerian Institutions

Colonization is regarded as an historical natural experiment in which there occurred substantial transformation of institutions in the colonized countries (Seilder, 2011). Alternatively, in most of the independent colonized countries, the origins of the existing institutional framework can be traced back to the colonial periods. There are three different lines of research which see the impact of colonization on the indigenous institutions. According to Engerman & Sokoloff (2000), the interaction of factor endowments with colonial rule created different levels of inequality in different societies. Thus, in societies founded with greater inequality, the elites gained more power to influence the choice of legal and economic institutions which, in turn, have implications for growth. Likewise, Acemoglu et al. (2001) argued that the choice of colonial institutions depended on settler mortality rates in the colonies.¹¹ In other words, the dangerous zones in terms of settler mortality rates were expected to have extractive colonial institutions. In a related study, Acemoglu et al. (2002) maintained that Europeans introduced extractive institutions in prosperous and densely settled areas.¹² Characterized by path-dependence, the colonial institutions persisted still in the independent countries which, in turn, explain the cross-country differences in the growth performance. The third line of research is based on the legal traditions of different colonial powers (North, 1990; La Porta et al., 1999; and Djankov et al., 2003). North (1990) considers the different ideologies of the Spanish and British colonialists and argues that British colonial institutions – characterized by freedom from expropriation and preference for trade – have

¹¹ In places where Europeans faced high mortality rates; they could not settle there and were more likely to set up extractive institutions. In contrast, in places where European faced low mortality rates; they settled there, and adopted institutions that could protect property rights and enforce contracts efficiently.

¹² For instance, the colonial power exploited the existing native institutions in the prosperous and densely populated colonies to force the local population to work in mines and plantations. In contrast, in sparsely settled areas, Europeans settled in large numbers and created institutions of private property, providing secure property rights to a broad cross section of the society and encouraging commerce and industry.

been central to economic development. Similarly, La Porta et al. (1999) as well as Djankov et al. (2003) conclude that the legal origins of the British Common Law are more prone to protect property rights as compared to the French Civil law. Consequently, the British colonies experience good institutional framework relative to those of the French.

British control over today's Nigeria started from the colonization of the settlement of Lagos in 1861. Later, from 1886 to 1900 the Royal Niger Company controlled the central Nigeria. Subsequently, its territories were amalgamated into the new Protectorate of Southern Nigeria. In 1906 the Protectorate of Southern Nigeria was merged with the Lagos Protectorate (Coleman 1971, p. 41-44). In 1900, it had started to extend its rule to the North of Nigeria by establishing the Northern Protectorate in January, 1900. Frederick Lugard, the first High Commissioner of Northern Nigeria, negotiated with the local emirs to accept the colonial rule. Most of them cooperated and the rest were defeated from Bida in 1901 to Sokoto in 1903. Finally, in 1914, the British united the coastal colony of Lagos with their protectorates of Southern and Northern Nigeria to form the present territorial shape of Nigeria.¹³

Onwards 1900 to Independence, the British applied the policy of indirect rule, especially in the Northern Nigeria. In particular, they restructured the local authorities and institutions and deposed those office holders who resisted. This policy created a compliant local power that furthered the interests of the British. Also, this policy was successful in avoiding any direct disruption of the region's social structures, including its dominant religion and culture.¹⁴ Local rulers were used to control the populace and raise revenue but were supervised by British officials who could veto their decisions.¹⁵ The administrative set up was centralized and hierarchical as all personnel remain unquestionably subordinate to top (colonial) authority.¹⁶ This patron-client type of hierarchical structure was characterized by

¹³ At the time of amalgamation a certain degree of administrative distinction between the Southern and Northern Nigeria was maintained (Crowder 1978a, p. 191). This reflected the enormous cultural differences of the ethnic groups which had been artificially united in one territory.

¹⁴ In reality, the policy of indirect rule had been created out of the necessity to rule a large and fragmented population with a minimum of resources.

¹⁵ According to Seidler (2011), only the treasury, railways, judiciary, military and post and telegraphs were managed centrally by Frederick Lugard who was appointed the first Governor-General of combined Nigeria in 1914. Most other things and day-to-day business was effectively regionalized in the hands of Lugard's two Lieutenant-Generals (one for the North and one for the South). Even working languages differed. The Northern administration used widely common Hausa whereas the South used English.

¹⁶ Duke II (2010) provides a basic structure of hierarchy, starting from High Commissioner and his two executive lieutenants. After these centralized authorities, comes the resident, divisional and district officers. The

tidiness and order in the work place; however, it destructively disrupted personal initiatives, creative thinking and innovation among the local people. Due to the colonial policy of cost minimization, little resources were allocated for the development of human capital. This resulted in the eventual creation of a workforce only good enough to carry out routine and non-creative tasks.¹⁷ Moreover, a large part of the creation of a professional bureaucracy in Nigeria came from the need to collect taxes in the colonial period. This led to the authoritative behavior on the part of the state officials which was one of the major consequences of hierarchical structure applied during the colonial period.

The economic structure of British rule in Nigeria constituted a classic open economy characterized by the exportation of agricultural commodities and solid minerals, and the importation of foreign manufactured goods. The trade in major commodities was officially regulated; and the focus was on international trade as state revenue mainly derived from the taxes on trade. Consequently, domestic markets developed mainly in areas which were off the international linkages and exports centers. This set up combined with the earlier agrarian structure of Nigeria resulted in subsistence farming during the colonial period. Commercial production was carried out only for exports; and it was carried out in those sectors which were of interests to British business firms. As a result, no genuine effort was made towards developing the technical and managerial capacity of local farmers beyond that of being mere producers of primary raw materials. Also, this policy limited the development of manufacturing sector, confining it to labor-intensive and light consumer goods for domestic consumption.

Despite the policy of indirect rule, the colonial rule introduced significant political, judicial and cultural changes. For instance, it was the Britain who initiated the federal structure in Nigeria. The regional divide into Northern, South Eastern and South Western parts of Nigeria laid out a roadmap for self-rule. The regions were granted autonomy over internal policy and administration, while the central colonial power retained authority over interregional policy and external affairs. Subsequently, the 1957 constitutional settlement, which the British had negotiated with nationalists, allotted representation in the federal

local content of the administration included native political agents, warrant chiefs, clerks, messengers and constables, who were merely subordinate field executors of colonial policies and decisions of the top hierarchy.

¹⁷ The core of the educational policy of colonization was to produce a literate, but junior clerical and mid-level manpower cadre fit to work at government offices, trading companies and sub-tertiary educational institutions. This meant that the authorities spent limited resources on the creation and development of educational institutions that would normally produce a workforce equipped with high level technical, innovative and managerial skills.

legislature on the basis of regional population. This provided the Northern region with an edge in the parliamentary system because it had 53 percent of the population according to a 1952 census. This arrangement was, further, ratified in the 1959 transitional elections, in which the Northern People's Congress (NPC) maintained a commanding position. However, the division of administration into three region structure and the consequent domination of center by the Northerners proved to be the main cause of subsequent regional conflicts. In other words, it proved to be the basis for ethnic politics in the independent Nigeria. Instead, the British could provide Nigeria with a national ideology because national ideologies have often proven to be successful in mitigating regional or ethnic cleavages.

4.2. Ethnic Fragmentation, Biafra War and Institutions

There is considerable literature on the implications of ethno-linguistic fragmentation for institutional and economic development. Mauro (1995), using ethno-linguistic fragmentation as an instrument for corruption, argued that ethno-linguistic fragmentation matters for government activities and economic outcomes. Likewise, Easterly and Levine (1997) have shown that per capita GDP growth is inversely related to ethno-linguistic fractionalization.¹⁸ La Porta et al. (1999) established an inverse relationship between ethno-linguistic fragmentation and the quality of institutions. It has also been shown that ethnic diversity affects the incidence of civil wars (Montalvo and Reynal-Querol, 2005b). Such institutional explanation of ethnicity gives three channels, i.e. political instability, rent-seeking policies and generalized corruption, and under provision of public goods, through which ethnicity can affect economic outcomes (Mauro, 1995; Easterly and Levine, 1997; La Porta et al., 1999; Alesina et al., 2003; and Montalvo and Reynal-Querol, 2005a).

The evolution of ethnic identities or regional cleavages in Nigeria can be traced back to structures consolidated by the colonialists in the process of combining Nigeria. In particular, the cleavages strengthened with the introduction of a three-region administrative structure (the North, the South East, and the South West) in 1947. Since then, ethnicity has dominated the other sources of *de facto* power in the process of politics and public administration. Nigeria comprises more than 250 ethnic groups, sharing the same country. However, the dominance of the three major groups has been intact in their respective regions throughout the Nigerian history. The regional division of these groups is such that the Hausa-Fulani (29 percent) predominate in the north; the Nupe and Tiv are in the middle regions; the

¹⁸ In particular, they argued that much of Africa's growth failure is due to ethnic conflict partly as a result of the absurd borders left by the former colonizers.

Yoruba (21 percent) is in the southwest; and the Ibo (Igbo) (18 percent) reside in the southeast. The other important minority groups that are politically salient are the Ijaw (10 percent) Kanuri (4.0 percent), Ibibio (3.5 percent), and Tiv (2.5 percent). Besides ethnicity, the North-South divide is also amplified by the religious divide. For instance, the far north is primarily Muslim and south contains a large number of Christians. Given this diversity, the population speaks close to 400 different languages and dialects.

Furthermore, the politically salient groups are characterized by different economic interests and endowments since the colonial times. For instance, the South was highly educated and urbanized due to their earlier acceptance of the British education system and other institutions. Additionally, their per capita income was augmented by their access to major centers of commerce and international linkages. In contrast, the northern parts were relatively under developed, and were isolated due to their traditional emirate rule. Thus, Nigeria got independence with this uneven level of development.¹⁹ However, the comparative advantage of the Northerners due to the 1957 constitutional settlement and their large population paralleled their earlier disadvantage in education and economic position. Given this advantage, the Northerners have dominated the central government since independence.²⁰

In the First Republic (October, 1960-January, 1966), the Hausa-Fulani's Northern People Congress (NPC) made a coalition government with the Igbo National Council of Nigeria and the Cameroons (NCNC) while the Yoruba party, Action Groups (AG) was in opposition. However, the coalition government did not work due to the specific political agenda that the Northerners had, based on their ethnicity and religion. For instance, the Northerners wanted to forge northern unity and restore the heritage of caliphate. Thus, the marginalization of and discrimination against the eastern Igbos resulted in a revolt by the Christian Igbo officers which ended in a coup in January, 1966.²¹ However, this was followed by a counter-coup in July, 1966 by the Northerners that resulted in the mass killings of southeasterners, mostly Igbos. The discontent, enhanced by ethnic competition, was manifested in Biafra Civil war (May, 1967 to January, 1970) in which the communities in

¹⁹ Suberu (2001) demonstrates this fact by showing that in the quota system of Nigeria; the students from the North have been accepted to the university at the expense of qualified students from the South.

²⁰ Collier (1996) quotes that the north needs to control the government in order to offset the large commercial advantages of the south in both export resources and education. This is based on the premise that the central government in Nigeria is center stage for distributing the pool of resources.

²¹ In the coup, Ahmadu Bello, the chief of NPC and several northern political and military leaders were killed.

south-eastern Nigeria, dominated by Igbo, declared itself as the Republic of Biafra.²² The war was mostly fought in the eastern regions, and it was concluded in favour of the Nigerian state. However, besides the human losses of more than 1 million, the Biafra war had long lasting effects on the inter-group relations, the institutional structure and the path of economic change (Okonta and Meagher, 2009). For instance, it reinforced the perception of the military as a means for maintaining the North's dominance in the federation.

Second, it intensified further the salience of ethnicity in the political process by raising demands for states creation. The break-up of Nigeria into twelve states in 1967 created new elites in the new states. The regional distributional demands increased further which, in a setting of weak formal institutions, created a social dilemma: individuals and regional groups focused on particular gains at the expense of collective goods and general welfare. The federal structure commonly strived to address the regional and ethnic demands through informal strategies. For instance, the informal dispensations and the bargaining among the various interests groups were the most often used instruments. In the same way, political consolidation was sought through some form of multiethnic coalitions. This type of distributional politics has reinforced a particular path of institutional development in Nigeria characterized by high levels of political discretion, a low salience of formal institutions, and widespread pressures on state for preferential benefits. Nigeria's poor economic performance is linked to this central problem of collective action.

4.3. Oil Revenue, Rent-Seeking and Dutch Disease

Empirical research on the implications of natural resources started to arise with the seminal findings of Sachs and Warner (1997, 1999, and 2001). Most of the earlier research gives the explanation incorporated in the Dutch Disease, *i.e.* the windfalls crowd out the manufacturing sector.²³ However, with the blossom of the institutional perspective of economic development, the interests in the institutional implications of natural resources also took surge (Sala-i-Martin and Subramanian, 2003). Two views emerge from this strand of literature. First, the abundance of natural resources increases corruption and rent-seeking

²² The nation of Biafra, declared by Odumegwu Ojukwu in 1967, comprised some of the communities in south-eastern Nigeria, the most dominant being Igbo. The ensuing war lasted from May, 1967 to January, 1970. The Biafra Civil War raised the question about ownership of the oil for the first time. The Eastern region claimed that the rent and royalties from the oil companies should be paid to the newly declared Republic of Biafra, while the Government of Nigeria argued that the revenues belonged to them.

²³ Dalgaard and Olsson (2008) provide us with a detail survey of the most of the earlier research on natural resources curse.

(Leite and Weidmann, 1999; Khan, 1994; Tornell and Lane, 1999; Torvik, 2002). Second, the availability and distribution of natural resources increases the possibility of civil wars (Collier and Hoeffler, 1998; Fearon and Laitin, 2003; De Soysa, 2002; Ross, 2001). Both of these views can be regarded as relevant in Nigeria. For instance, the Biafra war was partly arose due to the competition between the Northerners and the South-Easterners for resources. Similarly, corruption and rent-seeking is highly manifested in the populist measures taken during the windfall periods.²⁴

At the time of oil discovery in 1956, Nigeria was a low-income agrarian economy specializing in primary agricultural commodities like coca, palm produce, ground nuts and rubber. In the initial years, Nigeria was exporting oil but its contribution to exports earnings was minimal. Similarly, the Nigerian federal government had only limited involvement in the oil industry, comprising only to taxes and royalties on the oil companies. However, following the Biafra War which was considered by many as an attempt by the easterners to get access to the oil revenue, the government under the leadership of Yakubu Gowon nationalized the oil industry in 1971. Subsequently, the importance of oil increased significantly with two successive oil price hikes in the 1970s (1973 and 1979), making Nigeria one of the giants in the oil industry. Since then, the economy of Nigeria is oil based, locating Nigeria as the sixth largest oil exporter. In terms of oil production, Nigeria is presently the world's 14th largest producer of crude oil, producing roughly 2.2 million barrels per day and it has the 10th largest oil reserves in the world (CIA, Factbook). In 1970, oil revenue was a mere \$250 million but after the Organization of the Petroleum Exporting Countries (OPEC) embargo and price hikes following the Middle Eastern Yom Kippur war in 1973, revenues sprang from \$2.1 billion in 1972 to \$11.2 billion by 1974. These windfalls have led to the high concentration of Nigerian economy into petroleum sector.

A glance at table 4 will show the prominence of oil to exports earnings and government revenue. Since the first oil price shock (1973) to present, oil is contributing more than 30 percent to GDP, and is providing more than 70 percent of the government revenue. For instance, the percentage share of oil to government revenue abruptly increased from just 5 percent in the 1960s to almost 70 percent in the 1970s. Similarly, fuel exports as percent of total merchandised exports was around 25 percent in the 1960s. The oil price shock led it to almost 90 percent in the 1970s. Again, in most of the Nigerian history after the oil price shocks, oil is the major contributing unit to total exports, making more than 95 percent of

²⁴ For example, during the windfalls years, the Nigerian leaders adopted policies like price controls, subsidies, burgeoning public employment, extensive social provisions, protection and assistance for local entrepreneurs, expensive fiscal and monetary policies, and increased borrowing (Lewis, 2007).

exports earnings. Apart from its economic importance, oil is also playing significant role in the dynamics of politics in Nigeria. For instance, the federal government redistributes a significant share of the oil revenues to Nigeria's 36 states and 776 local governments (Bach, 2006).²⁵ Most of the Nigerian states have no independent source of revenue; and, thereby, they are reliant on the federation in order to main their current as well as development expenditure. Since, the central government has been formed by multi-ethnic coalitions throughout the Nigerian history; so, it has been merely a stage for the collection and distribution of oil revenues. Ethnic groups with more bargaining power obtain the greater share of this national treasure. This type of distributional conflict has resulted in frequent changes in the revenue sharing formula. As can be seen in table 5, it has been adjusted frequently to meet the regional demands at various times. Second, though the share of federal government decreased from 70 per cent in 1960s to around 50 per cent in 2000 but still 50 per cent of the total revenue is enough to invoke ethnic conflicts in a federation like Nigeria.

Table 4: Summary of Public Revenue of Nigeria**

Years	Total Revenue (\$ Million)	Oil Revenue (\$ Million)	Oil rents (% of GDP)	Total natural resources rents (% of GDP)	Oil Revenue (% of Total Revenue)	Fuel exports (% of merchandise exports)
1961-65	674.32	0.00	0.00	0.00	0.00	15.15
1966-70	903.48	46.65	3.25	4.46	5.16	36.62
1971-75	4501.87	3253.99	17.97	19.33	72.28	85.52
1976-80	16160.46	11148.77	33.15	34.34	68.99	93.19
1981-85	16903.99	11698.21	35.68	37.91	69.20	95.83
1986-90	7820.11	5597.20	32.67	36.38	71.57	94.24
1991-95	12025.10	9455.85	36.32	41.16	78.63	96.63
1996-00	20152.16	15207.68	33.22	37.03	75.46	97.48
2001-05	25222.85	20626.99	31.60	36.62	81.78	97.20
2006-08	52710.35	43887.74	31.32	36.85	83.26	93.50

Source: World Development Indicators, World Bank; Ministry of Finance, Government of Nigeria; Central Bank of Nigeria.

** The Values are taken as average for the corresponding period. So all the values are showing values per annum, on average.

²⁵ The distribution of Oil revenue is undertaken by the federal government since the nationalization of oil sector in 1971. Most of these states and local government entities rely heavily on this source of income.

Table 5: Nigeria's Division of Distributable Pool Account Revenue (as % of total)

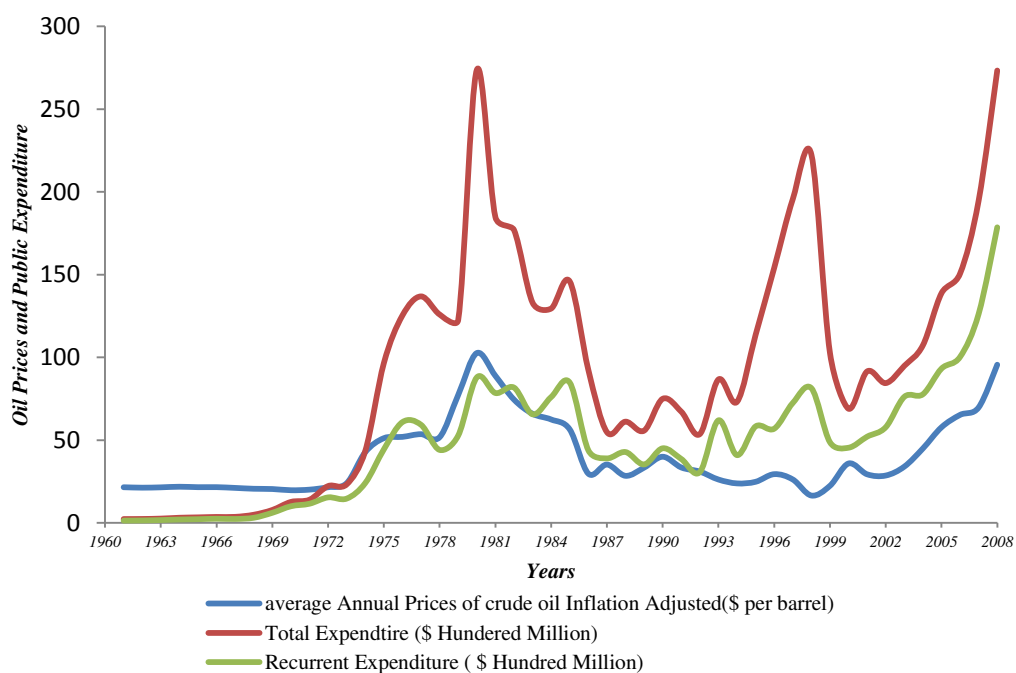
Recipients	1960-1962	1963-1966	1981 Act.	1984	1990	Jun. 1992	2002-To Date
Federal Government	70	65	55	55	50	48.5	52.68
State Government	30	35	30.5	32.5	30	24	26.72
Local Government			10	10	15	20	20.6
Special Funds**			4.5	2.5	5	7.5	
Total	100	100	100	100	100	100	100

Source: Salami (2011)

** Special Funds include recipients like development of oil producing areas, federal capital territory etc.

Similarly, the analysis of Nigerian public expenditure after the oil price shocks is shown in figure 2 and is summarized in details in table 6 in the appendix. In the figure, it is evident that during the oil boom period, total expenditure as well as capital expenditure increased significantly. For instance, in the whole 1960s, on average, total government expenditure was around 3% of GDP per annum; however, with the oil price shocks, it suddenly increased to 35% of GDP in 1970s and 40% in 1980s. Another significant feature of this increase is that the capital expenditure increased from less than 1% of GDP per annum in the 1960s to around 20% of GDP in 1970s and 19% in the 1980s. After the oil slump in the 1980s, the total expenditure suddenly decreased from around 58% of GDP per annum in the first half of 1980s to 22% of GDP per annum in the second half. Correspondingly, capital expenditure decreased from 29% of GDP per annum in the first half of 1980s to around 8% of GDP per annum in the second half. This is the indication of the fact that the surge in public expenditure was caused by the hike in oil prices.

Figure 2: Analysis of Nigerian Public Expenditure Vs Crude Oil Prices



Source: US Energy Information Administration, Ministry of Finance, Government of Nigeria

Nigerian capital stock grew at an average of 14 percent per year from 1973 to 1980. Despite this growth, the Nigerian over-investment in physical capital suffered from poor productivity (Collier, 1996; Sala-i-Martin and Subramanian, 2003).²⁶ The rise in public expenditure was an attempt by the actors involved in the federal structure to create and seize the rents in terms of corruption and kickbacks on contracts. The major example is financing the steel industry in the 1970s with the oil revenues. For instance, the building of the famous Ajakouta steel complex in the 1970s costed \$8 billion, which until today has not produced a commercial ton of steel. In the same way, other steel mills in Nigeria produce only sporadically and also, at a loss. It indicates that the government made a bad choice when it spent part of the oil windfall on building a steel industry. Likewise, in 1978, the civilian government recalled a contract for a dam which had been awarded at the price of \$120 million and re-awarded it at the astonishingly inflated cost of \$600 million (Bevan *et al.*, 1999). Thus, major portion of the resources windfalls, thus, went into the outlets of rents which were created by the proliferation of state-owned enterprises, the expansion of contracts and procurements, and the establishment of subsidies on services and basic commodities. The capital projects in the public sector increased the discretionary funds of bureaucrats which

²⁶ Collier (1996) points out that although public capital formation in Nigeria has been higher relative to most other developing countries but the return on public expenditure has been very low.

combined with the absence of fiscal oversight encouraged public officials to regard their offices as sinecures for extracting state resources. Second, it also resulted in the increased lobbying of interest groups over the location and control of these projects. Thus, politicians and civil servants were widely involved in business activities which blurred the distinction between the government and the private interests. In a sense, accumulation was structured around the collusion between businesses and state elites.

4.4. The Interaction between Colonization, Ethnicity and Windfall Rents

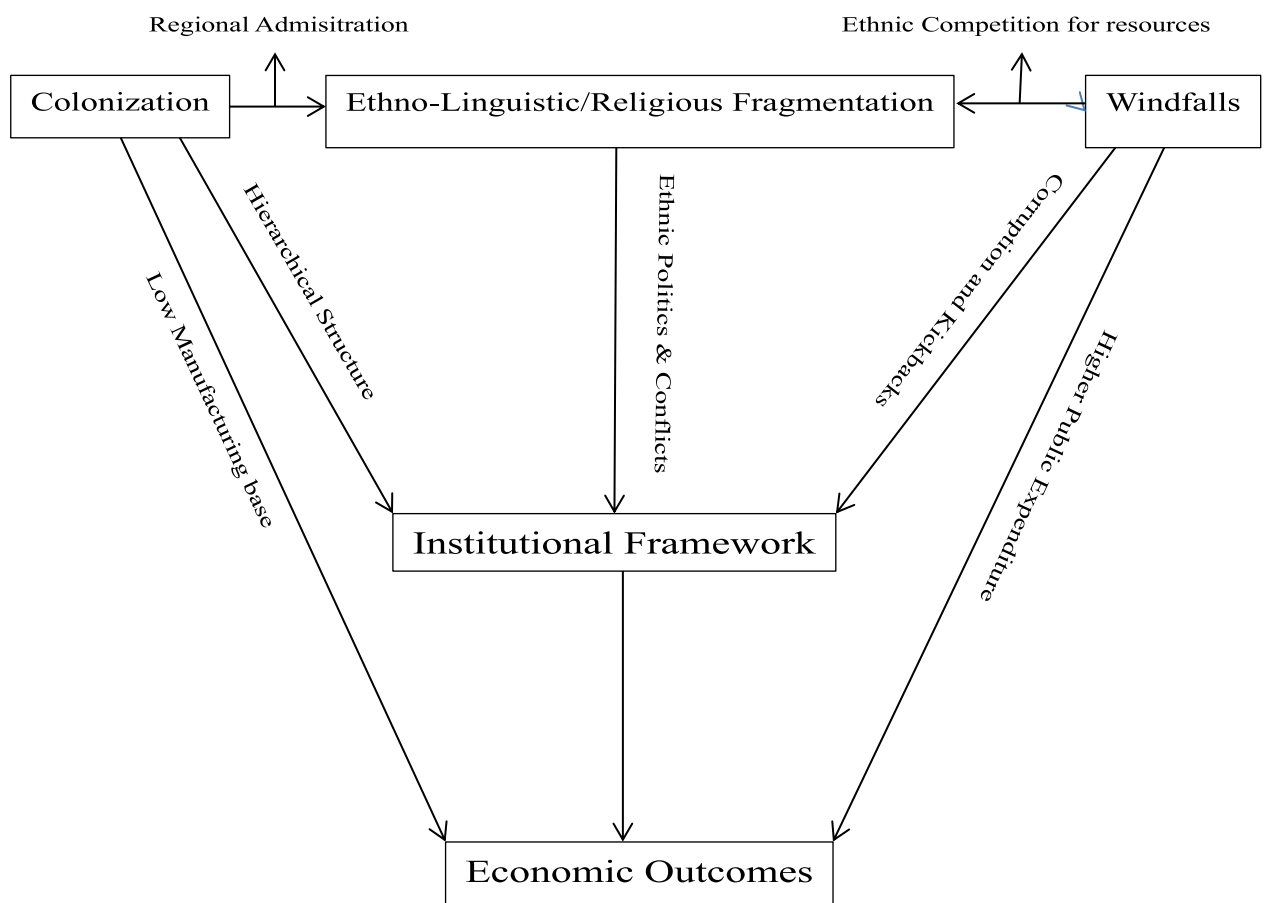
In this section, we propose how colonization, ethnicity and the oil rents interacted in the institutional and economic development of Nigeria. The proposed interaction is summarized in figure 3. The first and most important factor that shapes Nigerian institutions is its social divide. Ethnic politics in Nigeria is a struggle among fixed identity groups who contend over scarce resources (Nnoli, 1978; 1995). Alternatively, ethnicity serves as a central avenue for collective action in terms of political organization and participation. The resulting political structure has an ethnic character: the ethnic political parties shape the civilian governments; likewise, the military regimes reflect a clear sectional ruling group. In such a structure, rules have never been followed in the distributive contest among the various groups. Instead, the groups with power have been winning the contest. It is well-established that politics, shaped by ethnicity, result in the instability of operating institutional framework (Diamond et al., 1995).²⁷

Likewise, the colonial legacy has three impacts on the Nigerian structure. First, during the colonial times, the British officials were involved down to district level. The local suzerains were paid a fixed income out of the tax revenues they collected for the British. The administration, based on hierarchy, was an authoritarian one which became the basis of subsequent bureaucratic structure in independent Nigeria. Consequently, Public officials in Nigeria have been ruling instead of serving. Second, the colonial trade structure, ensuring the business interests of the British firms, was established in such a way that Nigeria could only

²⁷ Diamond et al. (1995) argue, the majoritarian principle is problematic in plural societies because ethnic parties that lose elections tend to reject not only the election results but also the whole gamut of democratic institutions by appealing to violence.

export raw materials and import manufacturing goods. Alternatively, British were little interested in the manufacturing sector of Nigeria which paved the way for a lower manufacturing base of independent Nigeria. Third, the colonial legacy-far from narrowing the differences between the peoples and providing a national coherent ideology- actually widened and deepened these differences. For instance, the British persisted with regional administrative units based on ethnicity: Hausa-Fulani in the North, Igbo in the South East, and Yoruba in the South West. This policy not only enhanced the ethnic competition between these three dominant groups, but; it also caused a feeling of marginalization in the other smaller groups. As a byproduct, it led to wide differences in the regions in terms of education, modernization and economic outcomes.

Figure 3: An Interaction between Colonization, Ethnicity and Windfalls



Source: Own Assessment

Similarly, windfalls have three effects on the Nigerian institutions and economic outcomes. First, the static effect was the increase in public expenditure during the windfalls years which contributed to the higher growth rates during that period. The other two effects are dynamic. First, it enlarged the effects of ethnicity by enhancing ethnic competition over the fixed bounty. The distributional politics, in turn, has weakened the Nigerian formal structure. In particular, the distributional conflict makes the allocation function more complex, i.e. the expenditures are undertaken by the state governments while the sources of finance are centrally-collected. Second, it resulted in the increased corruption and kickbacks on contracts. For instance, the windfalls expanded the role of state which, in turn, opened opportunities for unbridled corruption and profligacy in the process of national spending on industrialization and infrastructure projects. Entrepreneurs secured rents by colluding with public officials and exploiting many opportunities for arbitrage or fraud. However, in the end, the expansion in state activities could not develop an efficient manufacturing base.

5. Conclusion

In this study, we have endeavored to explain the interaction between extractive institutional structure and economic outcomes by providing evidence from Nigeria. After independence, Nigeria was expected to have potential for higher development due to its larger human and natural resources. But unfortunately, after five decades, the performance in terms of social and economic indicators is dismal. Nigeria is characterized by colonial heritage, ethnic and religious diversity, windfalls in the form of oil revenue, extractive institutional framework and poor economic outcomes. The main proximate factors that can explain the Nigerian under-development are Nigeria's over-dependence on some primary products and the petroleum sector throughout its history. Since 1961 to 2008, Nigerian state spent almost \$200 billion in capital formation but still it could not diversify its economy from its high concentration on petroleum sector to manufacturing. However, the extractive institutional structure is the fundamental cause leading this higher concentration on oil and lower manufacturing base.

Nigeria's formal institutional structure has evolved under the influence of three factors: colonial legacy, social fragmentation and windfalls from oil. The ruling strategies, ranging from colonial times to independent Nigeria, have been non-ideological, non-participatory, and have been mainly comprised rent-seeking policies. Social diversity has been vehemently used in politics by all the rulers including colonizers, military and the civilian ones. Thus, ethnic, regional and religious antipathies were spurred by group

perception of inequality and competition over public patronage. Corruption, short-sightedness and prebendalism were the outcomes that arose from such contentious distributional politics. The collusion among military officials, politicians, bureaucrats, and business cronies gave rise to convergence of interests around the emerging rentier state and politically regulated markets. As a result, the huge windfalls resulting from oil prices hike could not be managed in a manner to promote growth and benefit society at large. Instead, it steered to state-oriented expenditure bonanza which led to increased rent-seeking and kick-backs on contracts. The patronage system has shaped Nigerian politics and institutions individuals/groups-centered rather than welfare-oriented.

In this study, we have found that Nigeria ended up with poor economic and social outcomes due to its extractive institutional framework. Second, focusing on the three foundations of the Nigerian institutions, we have found that no single factor can explain the persistence of extractive institutions in Nigeria on its own. Instead, it is the combination of colonial legacy, ethnic-linguistic fragmentation and windfalls that have contributed to rent-seeking, extractive formal structure, and poor economic outcomes. Thus, more case studies need to be carried out in order to draw some general propositions about the theories established on the cross-country comparisons with regard to these three features.

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Appendix

Table 1: Major Economic and Social Indicators of Nigeria

Years	GDP per capita (constant 2000 US\$)	GDP per capita growth (annual %)	Adult Literacy Rate (in %, aged 15+)	Health Expenditure (% of GDP)	Life Expectancy (Years)	Expenditure of Education (as % of GDP)	Infant mortality rate (per 1000 live births)	Value of HDI	Fertility rate, total (births per woman)	Poverty headcount ratio at \$2 a day (PPP) (% of population)	Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	GINI index
1961-65	293.48	2.29			39.61		164.10		6.34			
1966-70	278.90	3.21			41.54		153.32		6.40		36.01	
1971-75	400.56	3.13			43.54	3.07	142.41		6.62			
1976-80	416.00	1.02			45.50	3.60	131.91		6.77			
1981-85	323.66	-5.20			45.90	1.40	125.24		6.74	76.96	53.93	38.68
1986-90	328.21	2.76			45.60	0.86	125.20		6.52			
1991-95	364.06	0.06	54.44	1.13	45.10	0.80	125.30		6.21	69.71	49.19	44.95
1996-00	366.48	0.07		1.32	46.30		116.48		5.97	86.44	68.51	46.50
2001-05	403.47	3.62	54.77	1.71	49.00		104.38	0.43	5.77	77.70	57.21	43.38
2006-10	496.26	4.06	61.00	1.78	50.48		92.70	0.44	5.61			

Source: World Development Indicators, the World Bank; Human Development Report, United Nations Development Programme

Note: The value is taken as the simple average for the corresponding five years, depending on the availability of data.

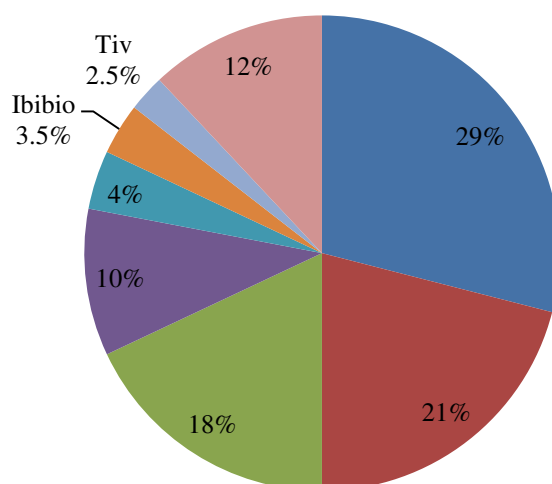
Table 2: History of Nigerian Rulers by Regime Type (1960-2010)

1960	Independence
1960-66	Abubakar Tafawa Balewa (Civilian Government of Northern People's Congress (NPC))
1966	J.T.U Aguiyi Ironsi (Military Government which Came Through a Coup after the murder of Abubakar)
1966-75	Yakubu Gowon (Military Government which initiated with a Counter-Coup in which J.T.U Aguiyi Ironsi was killed)
1975-76	Murtala Muhammed (Military)
1976-79	Olusegun Obasanjo (Military), after the murder of Murtala Muhammad
1979-83	Shehu Shagari (National Party of Nigeria)
1983-99	Muhamddu Buhari (Military) (1983-85), Ibrahim Babangida (Military) (1985-93), Ernes Shonekan (Civilian) (1993), Sani Abacha (Military) (1993-98), Abdulsalami Abubakar (Military) (1998-99)
1999-2010	Civilian (People's Democratic Party), Olusegun Obasanjo (1999-2007) Umaru Yar'Adua (2007-2010)

Source: CIA, Fact Book

Figure 1: Ethnic Groups as Percentage of Population

■ Hausa-Fulani ■ Yoruba ■ Igbo ■ Ijaw ■ Kanuri ■ Ibibio ■ Tiv ■ Others



Source: CIA Factbook, 2010.

Table 6: Summary of Public Expenditure of Nigeria**

Years	Total Expenditure (\$ Million)	Recurrent Expenditure (\$ Million)	Capital Expenditure (\$ Million)	GDP (constant 2000 Million US\$)	Total Expenditure (% of GDP)	Recurrent Expenditure (% of GDP)	Capital Expenditure (% of GDP)
1961-65	272.06	173.83	98.23	14409.29	1.89	1.21	0.68
1966-70	650.48	479.44	171.04	15321.47	4.25	3.13	1.12
1971-75	3990.21	2201.79	1788.42	24789.29	16.10	8.88	7.21
1976-80	15691.25	6097.10	9594.15	29640.73	52.94	20.57	32.37
1981-85	15405.37	7731.89	7673.48	26385.03	58.39	29.30	29.08
1986-90	6782.82	4119.26	2663.56	30507.37	22.23	13.50	8.73
1991-95	7885.32	4608.24	3277.09	38202.56	20.64	12.06	8.58
1996-00	14877.68	6095.95	8781.73	43272.84	34.38	14.09	20.29
2001-05	10339.20	7139.38	3199.82	53857.65	19.20	13.26	5.94
2006-08	20627.75	13507.41	7120.34	69966.83	29.48	19.31	10.18

Sources: World Development Indicator, World Bank; Federal Ministry of Finance, Government of Nigeria; and Central Bank of Nigeria.

** The Values are the average for the corresponding period. So all values are showing per annum values, on average.

Table 3: Comparative Institutional Indices Profile of Nigeria

World Bank*	Years			
Index Name	1996	2000	2008	Description of Variables (Based on Kaufmann, Kraay and Mastruzzi; 2007)
Government Effectiveness	-1.35	-1.06	-0.98	It combines into a single grouping responses on the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the Credibility of the government's commitment to policies.
Regulatory Quality	-1.13	-0.67	-0.62	"Regulatory Quality" includes measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.
Rule of Law	-1.42	-1.14	-1.12	"Rule of Law" includes several indicators which measure the extent to which agents have confidence in and abide by the rules of society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts. It measures that fair and predictable rules form the basis for economic and social interactions and the extent to which property rights are protected.
Control of Corruption	-1.26	-1.25	-0.92	The particular aspect of corruption measured by the various sources differs somewhat, ranging 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 elite forms to engage in "state capture".
Political Stability	-1.60	-1.63	-2.00	"Political Stability" combines several indicators which measure perceptions of the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means, including domestic violence and terrorism.
Voice and Accountability	-1.80	-0.72	-0.60	"Voice and Accountability" includes a number of indicators measuring various aspects of the political process, civil liberties and political rights. These indicators measure the extent to which citizens of a country are able to participate in the selection of governments. This category also includes indicators measuring the independence of the media.
Average Institutions	-1.43	-1.08	-1.04	It is taken as the simple average of all six indicators over the period.
Transparency International				
Corruption Perception Index	0.69	1.2	2.7	It is calculated by Transparency International and is measured as 0 (high corruption) and 10 (no corruption).
Heritage Foundation Freedom Indices**				
Investment Freedom	70	70	30	This factor scrutinizes each country's policies toward foreign investment, as well as its policies toward capital flows internally.
Financial Freedom	30	30	40	The financial freedom factor measures the relative openness of each country's banking and financial system.
Property Rights	50	30	30	This factor scores the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws.

* All the indicators of the World Bank ranges between -2.5 to 2.5 with higher score measures better outcomes.

**The indices of Heritage Foundation ranges between 0 to 100, with higher score indicates greater freedom.