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ASSESSING THE IMPACT OF INSTITUTIONAL QUALITY AND TRADE ON NIGERIA'S ECONOMIC PERFORMANCE

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Abstract

The impact of institutional quality and trade on economic performance was examined by this study. The data were obtained from Central Bank of Nigeria Statistical Bulletin and World Bank database for the year 1999 to 2023. The multiple regression technique was employed to analyse the parameters of the model. From the results of the study, institutional quality, import and exchange rate were found to be positive and statistically significant at 5 percent, while export was negative but statistically significant. Based on the findings of this study, it is recommended that government should improve on institutions to ensure quality operations by fighting corruption, respect rule of law and be transparent in all economic and political dealings. This would help to improve economic performance in Nigeria.

Keywords: Institutional quality, trade, exchange rate, economic performance, Nigeria.

JEL Classification Codes: B27, F31, G34, O47.

1.0 Introduction

Economic performance is significantly influenced by the quality of institutions and trade dynamics. Institutional quality, encompassing factors like governance, rule of law, and corruption control, affects economic efficiency by shaping the business environment and influencing investor confidence. High-quality institutions typically ensure better enforcement of contracts, reduce transaction costs, and foster a stable environment conducive to economic growth. Conversely, weak institutions can lead to inefficiencies, increased corruption, and economic stagnation (Udeh & Akinboade, 2022). Trade, on the other hand, allows economies to leverage comparative advantages, access larger markets, and benefit from economies of scale. By engaging in trade, countries can achieve higher productivity and growth rates. The interplay between institutional quality and trade is

crucial: strong institutions can enhance the benefits of trade by ensuring efficient market operations and reducing trade barriers (Aremu & Adeyemi, 2019).

In developed economies, robust institutions and trade openness have historically facilitated substantial economic growth. For example, countries like Germany and the United States have leveraged high institutional quality and expansive trade networks to become global economic powerhouses. The positive relationship between institutional quality and trade in these nations is well-documented, demonstrating that well-functioning institutions complement the benefits of trade (World Bank, 2023). However, the relationship is more complex in developing economies. Weak institutions can hinder the potential benefits of trade by creating unstable business environments and reducing investor confidence (Ogunleye, 2018). For instance, many Sub-Saharan African countries struggle with institutional weaknesses that limit their ability to fully exploit trade opportunities. Studies, such as those by Zulkefly et al. (2021) and Ugwuanyi and Eze (2023) have shown that institutional quality is a key determinant of the effectiveness of trade policies in promoting economic growth.

Institutional quality and trade in Nigeria are crucial to economic performance. Despite substantial trade potential, Nigeria's growth has been hampered by issues such as corruption, political instability, and inadequate infrastructure (Ogunleye, 2018). For instance, the World Bank's Governance Indicators highlight significant challenges in governance, with corruption and regulatory inefficiencies impeding economic progress. Trade policies, while ambitious, often suffer from implementation issues and lack of alignment with broader institutional reforms (World Bank, 2023). The Nigerian government has implemented various policies to address these challenges. Initiatives like the National Industrial Policy, the Economic Recovery and Growth Plan (ERGP), and anti-corruption measures aim to improve institutional quality and enhance trade performance. However, the effectiveness of these policies has been mixed. While there have been some improvements in governance and infrastructure, persistent issues such as bureaucratic inefficiencies and inconsistent policy implementation continue to undermine economic performance (Ighodaro & Anyanwu, 2020). While institutional quality and trade are critical to economic performance, Nigeria faces significant challenges in leveraging these factors effectively. The relationship between these elements is complex, and while policy measures have been introduced, ongoing reforms and stronger implementation are needed to realize their full potential. In view of this, the study examines the impact of

institutional quality and trade on economic performance.

2.0 Literature Review

2.1. Theoretical Framework

Endogenous Growth Model

Endogenous growth theory developed by economists like Paul Romer and Robert Lucas in the 1980s, offers a significant perspective on economic growth by emphasizing the role of technology, innovation, and human capital. Romer and Lucas argue that economic growth is driven by factors within the economy, particularly the accumulation of knowledge and human capital. This contrasts with earlier growth theories, such as those proposed by Solow, which treated technological progress as an external factor. The theory assumes that technological innovation and human capital are crucial drivers of economic growth. It posits that investments in education and research can lead to higher productivity and growth rates, as they contribute to the creation of new technologies and ideas. The theory was however criticized that the theory does not adequately address the role of institutional factors and market failures that can hinder technological progress and human capital accumulation. Additionally, the assumption that all forms of investment in knowledge and human capital will lead to growth has been questioned, with some suggesting that the benefits of such investments may be unevenly distributed or that they might not always translate into immediate economic gains. Despite the criticisms of the theory, it remains relevant in the sense that quality institutions, human capital development and technological innovation matter for growth and development in an economy (Romer, 1986; Lucas, 1988).

2.2. Review of Empirical Literature

Emmanuel et al. (2024) examined the impact of government expenditure and institutional quality on economic growth. Dynamic ordinary least square (DOLS) was employed and the research was conducted from 1990 to 2022. Results of the findings indicate that government spending has a substantial and favourable effect on economic growth, and the findings also demonstrated that the presence of institutions has a substantial and favourable impact on the economic development of Nigeria.

Ugwuanyi and Eze (2023) investigated the impact of institutional policy on foreign direct investment (FDI) in Nigeria during the period 1986 – 2019. ARDL co-integration bound test and ARDL estimation technique was employed, the study revealed that political instability, corruption index, terrorism index negatively and significantly affects the inflow of FDI in the short-run and the long-run. While voice and accountability, rule of law, government effectiveness, gross fixed capital formation and trade openness positively and

significantly impacted on FDI and the growth of the economy.

Ojo, et al. (2023) investigated the impact of institutional quality on the economic performance of Nigeria from the period of 1996 – 2021. Unit root test, Johansen cointegration, and the Error correction model were used. From the findings it was revealed that there is sustained nexus between the quality of institutions and characteristics related to economic growth. Also, it was equally found that political instability would definitely amount to a decrease in economic performance in Nigeria during the period under investigation.

Ijaz et al. (2023) investigated the relationship between institutional quality and economic development, using the Human Development Index (HDI) as a measure, across 70 developing countries from 2002 to 2018. The study employed various advanced econometric techniques, including the CIPS unit root test, Westerlund (2007) co-integration test, and the cross-sectionally augmented autoregressive distributed lag (CS-ARDL) model. To ensure robustness, additional methods such as Fully Modified Ordinary Least Squares (FMOLS), Dynamic Ordinary Least Squares (DOLS), Augmented Mean Group (AMG), Impulse Response Function (IRF), and Variance Decomposition Analysis (VDA) were used. The results indicated that institutional quality and globalization exert a positive influence on the HDI, while inflation, unemployment, and corruption negatively affect human development.

Temidayo et al. (2022) investigated the role of institutional quality on the causal nexus between trade protectionist policy and macroeconomic performance in Nigeria from 1981 – 2019. Autoregressive distributed lag (ARDL) model and VAR Granger causality test were adopted. Findings revealed that due to the high level of corruption and low level of government effectiveness in the economy, institutional quality plays a negative role in the relationship between trade protectionist policy and macroeconomic performance in Nigeria. It is also revealed that trade protectionist policy causes and significantly explains changes in the exchange rate and economic growth in Nigeria.

Zulkefly et al. (2021) examined the relationship between institutional quality and economic growth in Jordan for the period 1996 to 2017. The study employed autoregressive distribution lag (ARDL), the findings shows that there is a positive and significant relationship between institutional quality and economic growth in both long-run and short-run.

Timothy (2021) examined the relationship between the quality of institutions and the economic performance of Nigeria covering

the period 2000 – 2019. Using time series, augmented dickey-fuller and Phillips-perron unit root test, it was found that the variables are stationary at order I(I). The Engle-granger co-integration technique confirms the existence of long-run relationships among the variables. The results of the OLS estimation of ECN model indicate strong positive and significant relationship between institutional quality variables and the economic performance of Nigeria.

Folasade et al. (2020) established the effect of institutions challenges on the FDI inflow and how it impacts on economic development for host selected countries in sub-Saharan African (SSA), for the period of 2000 – 2018. Fixed and random effect regression model was employed. The findings revealed that foreign capital inflow is crucial for economic development in the SSA sub-region of Africa. Quality of institutions as determining factors also affected the level of inflow of FDI to the host SSA sub-region, which resulted in underutilization of domestic resources and hence abnormal development of domestic sector investment.

Sule (2020) ascertained the effect of institutional quality through contract intensive money and effective governance index to economic growth in Nigeria for the period of 1979 to 2018. Both Johansen cointegration and ordinary least square (OLS) approach was employed. OLS model shows that economic growth responds positively to institutional quality (contract intensive money) is statistically significant. The estimated cointegration test reveals joint relationship among the variables while effective governance index exerts positive and insignificant influence on the economy.

Fisayo & John (2018) examined the long-run and short-run dynamic relationship between institutional quality and financial development in Nigeria covering the period 1984 –2015. Auto- regressive distributed lag (ARDL) bounds test approach to cointegration was used. The results shows that institutional factors do not have significant effect on financial development in the long-run as well as in the short-run.

3.0 Data and Method

3.1. Model Specification

The multiple regression model is adopted for this study to examine the impact of institutional quality and trade on economic performance in Nigeria. This method is more amenable to ceteris paribus because it permits to control explicitly for many other factors that simultaneously influence the dependent variable. In the study, the model of Ojo et al. (2023) is adapted and the model is specified as;

$$RGDP = f(INQ, POL) \quad (3.1)$$

Where, RGDP is real gross domestic product; INQ is institutional quality; POL = political stability.

This current study modified the model of Ojo et al. (2023) and included variables such as institutional quality, total imports, total exports, exchange rate as explanatory variables, while real gross domestic product was introduced as the dependent variable. The model for this study is thus specified in its functional and econometrical forms respectively as;

$$RGDP = f(INSQ, IMPT, EXPT, EXCR) \quad (3.2)$$

$$RGDP_t = \beta_0 + \beta_1 INSQ_t + \beta_2 IMPT_t + \beta_3 EXPT_t + \beta_4 EXCR_t + \varepsilon_t \quad (3.3)$$

3.2. Estimation Procedures

The cointegration test is run after the unit root test, which uses the Augmented Dickey-Fuller test to verify stationarity. The Johansen cointegration test is used to perform the cointegration test, which is the long-run test. The multiple regression approach is used once the long-term link has been established. After that, a few diagnostic tests were conducted to demonstrate the validity and dependability of the study's model.

3.3. Nature and Sources of Data

Based on annual time series, this study compiles data from the Central Bank of Nigeria Statistical Bulletin and the National Bureau of Statistics.

4.0 Data Analysis and Interpretation of Results

This section presents the results of the tests carried out to establish the objectives of this study, and also interprets the results for clarity and to empirically ascertain the relationship between the explanatory variables and the dependent variable.

Stationarity Test

Table 4.1: Summary of the ADF Unit Root Test

Variables	ADF Stats	Critical Value @5%	Order of Integration	Remarks
RGDP	-3.0760	-2.9571	I(1)	Stationary
INSQ	-5.7354	-2.9719	I(1)	Stationary
IMPT	-4.0257	-2.9678	I(1)	Stationary
EXPT	-5.9753	-2.9604	I(1)	Stationary
EXCR	-5.3324	-2.9571	I(1)	Stationary

Source: E-views 12 Output.

The result presented in Table 4.1 shows that the variables such as real gross domestic product (RGDP), institutional quality (INSQ), total imports (IMPT), total exports (EXPT), and exchange rate (EXCR) are all stationary at first difference. Thus, the null hypothesis that unit root exists is rejected. It is then concluded that the variables are all stationary and can no longer produce spurious regressions.

Cointegration Test

Table 4.2: Summary of Johansen Cointegration Test

Unrestricted Cointegration Rank Test (Trace)					
Hypothesized		Trace	0.05		
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**	
None *	0.558494	70.87621	69.81889	0.0411	
At most 1	0.509691	44.71419	47.85613	0.0958	
At most 2	0.273255	21.90718	29.79707	0.3037	
At most 3	0.201359	11.69342	15.49471	0.1722	
At most 4 *	0.131142	4.498420	3.841465	0.0339	
Unrestricted Cointegration Rank Test (Maximum Eigenvalue)					
Hypothesized		Max-Eigen	0.05		
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**	
None	0.558494	26.16202	33.87687	0.3110	
At most 1	0.509691	22.80701	27.58434	0.1819	
At most 2	0.273255	10.21376	21.13162	0.7243	
At most 3	0.201359	7.195003	14.26460	0.4663	
At most 4 *	0.131142	4.498420	3.841465	0.0339	

Source: E-views 12 Output.

From the result in Table 4.2, trace statistic has two cointegrating equations, while max-eigen statistic has one cointegrating equation. This implies that there exists long run relationship among the variables.

Parameters Estimation Test Result

Table 4.3: Summary of Multiple Regression Model

Dependent Variable: RGDP				
Method: Least Squares				
Date: 09/06/24 Time: 18:19				
Sample (adjusted): 1994 2023				
Included observations: 30 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.048846	0.226435	13.46458	0.0000
INSQ	0.389641	0.169412	2.299965	0.0301
IMPT	0.179285	0.038155	4.698919	0.0001
EXPT	-0.096421	0.038913	-2.477844	0.0203
EXCR	0.279724	0.049389	5.663665	0.0000
R-squared	0.894059	Mean dependent var		4.647848
Adjusted R-squared	0.877109	S.D. dependent var		0.198547
S.E. of regression	0.069602	Akaike info criterion		-2.341028
Sum squared resid	0.121112	Schwarz criterion		-2.107495
Log likelihood	40.11542	Hannan-Quinn criter.		-2.266319
F-statistic	52.74514	Durbin-Watson stat		1.881599
Prob(F-statistic)	0.000000			

Source: E-views 12 Output.

The multiple regression result showed that institutional quality (INSQ) has positive and significant impact on economic performance. The coefficient value is 0.3896 and p value is 0.0301, meaning that on average, 1 percent increase in INSQ will increase real GDP by 0.39%. This conforms with the a priori expectation and also in tandem with the findings of Emmanuel et al. (2023) since institutional quality enhances smooth operations of all activities in an economy.

The coefficient value of import is 0.1793 with the p value of 0.0001. This suggests that 1 percent increase in total imports on average would increase economic performance by 0.18%. The implication of this is that import contributes to overall economic performance since Nigeria is an import-dependent country and that no country can survive or produce all what the citizens would need to satisfy their wants without importing from other countries of the world. The finding conforms to the a

priori expectation but failed to support Shido-Ikwu et al. (2023) who found that import trade has negative impact on economic growth.

Similarly, exchange rate has positive impact on economic growth with the coefficient value of 0.2797 and significant p value of 0.0000. This simply implies that on average, when exchange rate is increased by 1 percent, economic performance will increase by 0.28%. This finding failed to conform to the a priori expectation due too high exchange rate that has aggravated the prices of goods and services owing to the fact that Nigeria is an import dependent economy. With the positive and significant impact of exchange rate on economic performance, the findings failed to corroborate the findings of Shido-Ikwu et al. (2023).

On the other hand, total exports have negative but significant impact on economic performance in Nigeria. The finding reveals that when total export is increased by 1 percent, economic performance will reduce by 0.09%. This is not in tandem with theoretical proposition because more exports mean more economic activities which would boost economic performance are happening in the economy. It is also not consistent with the findings of Shido-Ikwu et al. (2023) which revealed that export trade has positive impact on economic growth in Nigeria.

The coefficient of determination (R^2) indicated that 89% variations in real gross domestic product are explained by institutional quality, exchange rate, total imports and exports, while 11% changes are captured by error term. The F-statistic of 52.7451 implies that the variables are also jointly statistically significant at 5 percent. The Durbin-Watson statistic indicates that the model is free from autocorrelation.

Diagnostic Tests

Normality Test

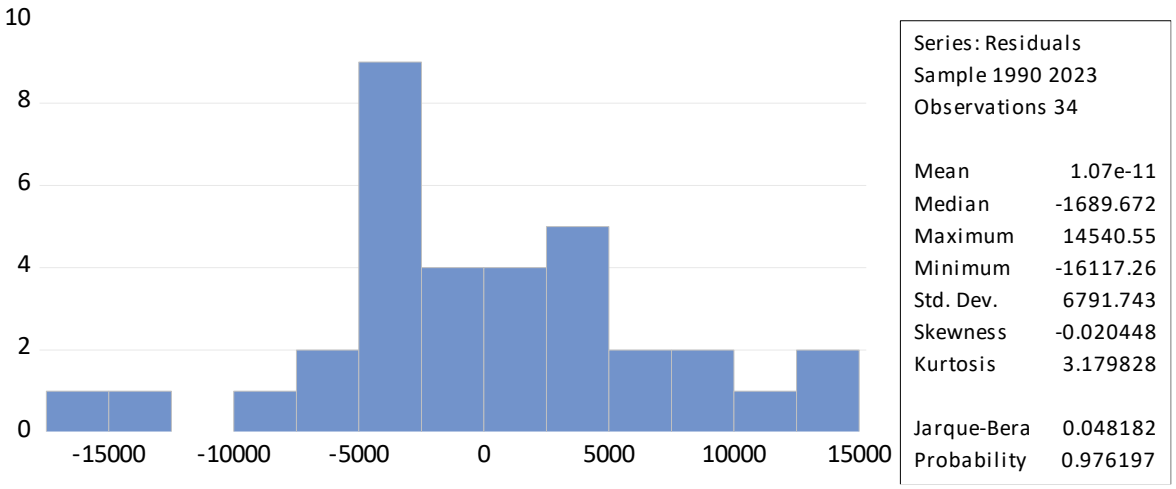


Figure 4.1: Histogram Normality Test

Source: Eviews 12 Output.

The normality test in Figure 4.1 affirms a normal distribution as the probability value of Jarque-Bera which is 0.9762 is greater than 0.05. The study therefore concludes that the model is normally distributed.

Heteroscedasticity Test

Table 4.4: Heteroskedasticity Test: Breusch-Pagan-Godfrey

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
Null hypothesis: Homoskedasticity			
F-statistic	0.980908	Prob. F(4,25)	0.4358
Obs*R-squared	4.069647	Prob. Chi-Square(4)	0.3967
Scaled explained SS	2.619666	Prob. Chi-Square(4)	0.6233

Source: Eviews 12 Output.

The result of the heteroscedasticity implies that the residual is homoscedastic since the probability value of F-statistic which is 0.4358 is greater than the critical value at 5 percent. This results to the study concluding that the null hypothesis is accepted and that the model is free from heteroscedasticity.

5.0 Conclusion and Policy Recommendations

The study examined the impact of institutional quality and trade on economic performance in Nigeria between 1990 and 2023. These periods were chosen due to availability of data and the multiple regression technique was used to analyse the data. From the findings of the study, institutional quality, total imports and exchange rate have positive impact while total export has negative impact. It was further shown that all the variables are statistically significant at 5 percent. Similarly, the goodness of fit showed that the model has high explanatory power as the independent variables were able to explain 89% variations in the dependent variable. Based on the findings of this study, it is concluded that institutional quality and trade can boost economic performance in Nigeria.

As a result of the findings, the following recommendations are made;

i. Government should fight corruption, respect rule of law and ensure accountability for every activity as this would ensure smooth economic activities and improve economic performance the more.

ii. Import has positive impact on economic performance. As such, government

should reduce the importation of final goods and concentrate majorly on intermediate goods and raw materials for production. This would help to improve economic performance in Nigeria.

iii. Although exchange rate has positive and significant impact on economic performance in Nigeria, there is need for the government to ensure the stability of exchange rate. This can be done by focusing on more export than import.

iv. Export has negative impact on economic performance because government import more than it exports. Thus, there is need to ensure that the environment is conducive for investments by fighting insecurity. This would propel the investors to invest and more goods and services can be made available for exports.

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