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RENT-SEEKING, INSTITUTIONS AND ECONOMIC DEVELOPMENT: A TALE OF RENT-SEEKING SOCIETY

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Abstract

The institutional perspective of cross-country differences in economic outcomes gives contrasting explanations on the persistence of inefficient 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 descriptive analysis, we find that the lack and incoherence of formal institutional order is the main factor for Nigerian underdevelopment. Ethnic politics has shaped the formal institutional framework which is inefficient and incoherent. 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 inefficient institutions; rather, it is the combination of exogenous and endogenous factors that shape institutions.

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

Key Words: Cross-country Differences in Economic Outcomes, Colonization, Social Fragmentation, Natural resources, Nigeria

1. Introduction

Cross-country differences in income have been one of the contentious issues in economic theory almost since the last century. In

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general, research in this area has been focused on the question "what causes growth?" Different answers have been provided to this question, and can be classified mainly under three groups. One group is the exogenous growth theory whose main claim is that sustained growth is led by exogenous technological change and in the absence of such change, a steady-state growth rate tied with the population growth rate is the long run outcome (Solow, 1956; Swan, 1956; and Cass, 1965). Second, the endogenous growth theory endogenizes the technical change, and asserts that technological progress occurs as a result of the profit maximizing motive of firms and inventors (Lucas, 1988; Romer, 1986 and 1990; and Aghion and Howitt, 1992). The third view is the institutional perspective. This strand of research, blossomed recently, has led to the conclusion 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).[1]

This paper is related to the third school of thought. The institutional economists assert that the selection and persistence of inefficient institutions is the main factor responsible for lower growth performances across the world.[2] Several explanations, in turn, have been provided for the persistence of inefficient institutions. For instance, colonization, social fragmentation, and the presence and use of natural resources are the most frequently discussed causes in the available literature. This paper has two goals: first, it is intended to review some of the recent theoretical and empirical research on the institutional perspective of economic development; second, we illustrate the fact that no one factor on its own can account for the persistence of inefficient institutions across societies. The latter objective is exemplified with the help of the case study of Nigeria. We argue that the rent-seeking behaviour of interest groups in a society results in the inefficiency of

[1] The details of different approaches to economic growth are given in the book titled as "Handbook of Economic Growth" edited by Philippe Aghion and Steven Durlauf, first published in 2005.
[2] The proximate factors like capital and technology are mobile to some extent and, therefore can be exchanged across societies. The only immobile factors are the set of formal and informal institutions.

institutional environment which, in turn, has implications for the long run economic outcomes. However, this behaviour 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 [1]. Instead, in this study, we provide a case study of Nigeria which is an important case for institutional economics due to its three distinguishing features mentioned earlier. 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.

Second, the aforesaid three features of Nigeria have collectively evolved the Nigerian formal institutional framework. For instance, the Nigerian social divide, whether it is religious divide or ethno-linguistic divide, shapes Nigerian informal institutions which, in turn, regulate formal institutions.[2] Second, the colonization experience provided Nigeria with the inherited system of formal institutions from British which, characterized by path-dependence, persisted even after independence. Third, Nigeria has been endowed with enormous windfalls in the form of petroleum sector. The distributional issues of the windfalls often invoked social conflicts, resulting in frequent changes in formal rules related to resources control and sharing. 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

[1] For instance, Hodgson (2006) suggested that "institutions can be best understood within the specific historic, geographical, social etc. context".

[2] Formal institutions are only enforceable if they are supported and legitimized by informal institutions. According to Hodgson (2006), the formal declaration of a law is not enough to make it a reality. In order to matter, it should be rooted in the customs and observances of the people.

(1997, 2001), proclaims that the countries with abundant natural resources are more prone to be caught by the famous Dutch Disease.[1]

Combining these features together, this case study would provide us with the analysis of how each of the three affects formal institutional framework? Second, it would enhance our grasp on how colonization, social divide, and natural resources interact in a single society.

The rest of the paper is organized in seven sections. Section 2 sets out the underlying theoretical framework of the study, and clarifies the basic concepts used in this study. The economic, social and institutional background of Nigeria is provided in section 3. we analyze the colonial legacy in section 4. The main focus is on the process of colonization, the ruling strategies of the British, and its subsequent implications for Nigerian institutions. Regarding social diversity, our hypothesis is that the fragmentation provided the British and the successive independent rulers with an instrument to manipulate political decisions and institutions in their favour. This analysis, ranging from colonial times to independence and the resulting Biafra war, is shown in section 5. Finally, the exploration of oil in the 1960s and the succeeding oil prices surge in the 1970s led to a persistent rent-seeking amongst the privileged groups. We illustrate in section 6 that oil has affected Nigerian economy from two sides. First, it has led to a high concentration of the economy around the petroleum sector, making foreign exchange earnings and government revenue highly dependent on oil. Second, the privileged groups, under the auspices of state, seized rents through higher public expenditure during the oil price shocks. Section 7 gives the possible interactions between colonization, ethnicity and windfalls, and demonstrates their implications for Nigerian formal institutions. Section 8 concludes the paper.

[1] 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.

2. Basic Concepts and 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”. He argued that the latter is more important because against all other predators there is a hope of defending oneself. So, 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.)[1]. In other words, there is some level of state interference in private activities that is efficient relative to stateless mechanism or disorder. However, the regulation of economic activities by the state inevitably creates interest groups. There exist incentives for these groups to control the state in order to accrue the benefits, created with state intervention. Their efforts and resources wasting activities are summarized in the famous rent-seeking theory (Tullock, 1967; Stigler, 1971; Krueger, 1974; Posner, 1975).[2]

According to the traditional rent-seeking theory, an important function of the government is to create and distribute rents through regulation, or more generally to define and enforce property rights. The interest groups affected by such regulations have an interest in investing resources in trying to influence such decisions. Correspondingly, politicians, interested in maximizing votes and reelection, seek their support in the form of votes and campaign contributions. The interest groups provide the votes and campaign contributions with the hope that, once elected, the law-maker will support special-interest legislation to create rents or improve their rent-extracting ability. Thus, the rent-seeking of various groups in the interplay of state results in the adoption of rules or

[1] 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.

[2] Rent-Seeking meant the resource-wasting activities of individuals and groups in seeking transfers of wealth through the aegis of state. Although, originally the theory was motivated by the rent-seeking in governmental regulation, but this is not the only setting in which rent-seeking may occur.

economic policies that impose significant costs on a large and poorly organized population. In this paper, we take a broader picture of interest groups in a society. The analysis is based on two assumptions: First, interest groups have solved their within group problems of collective action and free riding. Second, they are organized by their interests aiming at maximizing their state accrued benefits. Based on these assumptions, we want to make an argument that interest groups, characterized by asymmetries in their bargaining power, manipulate institutional framework by invoking popular ideology and exploiting ethno-linguistic fragmentation besides resources wasting activities. Their activities may not be in line with those that maximize the aggregate welfare.

Broadly classifying, in a particular society, the rent-seeking interest groups may be either private or public. They are differentiated mainly by their source of political power.[1] The private interest groups possess the *de facto* power while the public interest groups have the *de jure* power. For instance landed aristocracy or industrialists as interest groups have the *de facto* power in the form of their resources. They may manipulate political decisions or institutional rules in their favour by campaign contributions or lobbying etc. Interests groups shaped by ethno-linguistic fragmentation or religious denomination may change the rules of the game by using their *de facto* power, associated with the number of people following the corresponding group. In the same way, public interest groups like the ruling class, judiciary, bureaucracy, and the military have the *de jure* power to influence rules and regulations. Thus, the political power summed by the *de facto* and *de jure* components shapes institutions, which in turn, determine the long-run economic outcomes.

Most of the colonized countries are characterized by a kind of social coordination that is called “arbiter-client hierarchy”. This is because, during 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

[1] Acemoglu and Robinson (2006) distinguish between two sources of political power i.e. *de jure* power and *de facto* power. *De facto* power is the ability of a group what it can do to other groups and the society at large by using force or resources. In contrast, the *de facto* power is the political power, which is allocated by political institutions.

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 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 rent as a reward for bringing the 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, were endowed with special privileges like monopoly rights, import quotas, 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, a western African country of around 152.22 million people, is the most populous country in Africa and the 8th most populous in the world. It comprises 36 states and Abuja, the federal capital territory. Besides, it is characterized by enormous social divide. Equally, it has a variety of ecosystems ranges from wetlands and tropical forests in the southern lowlands to savannah and semi-arid plains in the north. In terms of economic position, Nigeria has the third biggest economy by Gross Domestic Product (GDP) in Africa behind South Africa and Egypt. The country possesses abundant fertile land as well as substantial natural resources. 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 conflict. The formal institutional structure is authoritarian since the colonial times.[1]

The politicization of ethnicity and religion is a direct by-product of the monopolization of power and assets by the ruling elites eager to avoid open and fair competition. High dependence on oil has resulted in a pervasive patron-client networks at all levels of government. In the absence of checks and balances on the rulers, dominated by the military ones, the state has failed to fulfill most of its major regulatory functions. The administration is malfunctioning, and is infested with high corruption. The institutional economists would conclude that the Nigerian poor economic outcomes would be caused by its incompetent institutional framework.

3.1 Performance on Economic and Social Indicators

Since independence, Nigeria has been the most challenging developing country with spectacularly failed institutions and poor economic outcomes. A summary of its economic and social indicators is given in table 1 in the appendix. For instance, in constant 2000 US $ terms, Nigeria's per capital GDP 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. It places Nigeria worse than the average country in terms of growth performance. Besides poor economic outcomes, the growth rate in Nigeria is characterized by volatility. From the 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.

[1] Nigeria has the same colonization history like most of the other African countries. It was colonized by the British and its colonization experience ran from 1800 to October, 1960.

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.[1]

Concurrently, in constant 2000 US $ terms, from 1970 to 2009, Nigeria's cumulative revenues from oil have amounted to about $480 billion (see table 3 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. It indicates that during its first 40 years, Nigeria has performed poorly given its abundance of natural and human resources. 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. 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).

In terms of human development, 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 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

[1] 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.

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.

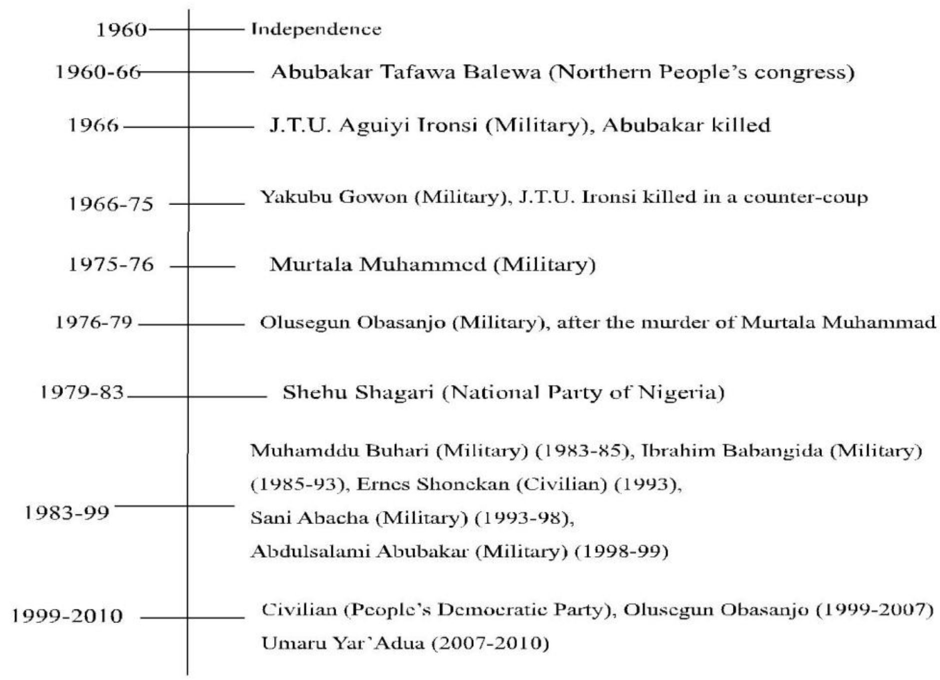
3.2 Institutional Framework

It is often cited that Nigeria has not been able to consolidate stable political regimes or establish capable state organizations. Politics is based on patronage, clientalism, rent-seeking, and ethnic cooperation as without these means political leaders are considered to be insecure (Lewis, 2007). The inability of the state to establish credible commitment, in turn, has vitiated economic policy and undermined capital formation. To argue that the failure of Nigerian development stems from the absence of a political and institutional order, we provide two types of evidences on Nigeria institutional framework. Firstly, we give a descriptive history of the past Nigerian regimes and subsequently, we enrich our evidence with the comparative indices by the international agencies. Nigeria has been under military rule for 30 years out of its 52 years history. Besides its political instability, 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.

Since independence, as is shown in figure 1, more than half of its rulers are either assassinated or removed in military coups. The first republic headed by the Prime Minister, Abubakar Tafawa Balewa was eliminated in 1966 with a coup by Johnson Aguiyi Iransi. Subsequently, J.T.U, Aguiyi Iransi was killed by the subsequent coup under the leadership of Yakubu Gowon in the same year. In the same way, Yakubu Gowon was dethroned with a coup headed by Murtala Muhammed in 1975. In the next year, Murtala Muhammed was assassinated with a coup by Olusegun Obasanjo. Olusegun Obasanjo ruled from 1976 to 1979 when he retired and called elections to make what is called the second Republic in the history of Nigerian rulers.[1]

[1] The return to civil rule in 1979 was accompanied by a new constitution, replacing the First Republic Constitution of 1963. The major change was the abolishment of the Westminster parliamentary system to a more American like presidential system.

Fig 1: History of Nigeria's Rulers by Regime Type



Source: CIA, Fact Book

In the Second Republic, the civilian institutions ruled for the second time under the leadership of Shehu Shagari until the 1983‟s coup by Muhammedu Buhari. From 1983 to 1999, the military again ruled the country with various head of states at different times (Muhamddu Buhari, 1983-85; Ibrahim Babangida, 1985-93; Ernes Shonekan, 1993; Sani Abacha, 1993-98; Abdulsalami Abubakar, 1998-99. Since 1999 to date, again, the civilian institutions are ruling (Olusegun Obasanjo, 1999-2007; Umaru Yar‟Adua, 2007-2010).

Given the evidence, it is concluded that Nigeria is lacking political institutions. In the sense of North‟s (1981) constitutional rules, Nigeria is a society with unpredictable constitutional rules which, in turn, have severe implications for North‟s (1981) operating rules. The comparative analysis of the institutional quality indices, summarized in table 2 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. Limited freedom has led the state to be elite centred where the competition between the elites is merely access to politically mediated resources. Central authorities and institutions lack coherence to provide North (1981)'s incentive structure. Thus, the prevailing institutional framework that has not led to the alleviation of the transaction costs has ruinous consequences for long run economic outcomes.

4. Colonial Legacy and Nigerian Institutions

Colonization is regarded as an historical natural experiment in which there occurred substantial transmission of European institutions across the globe.[1] The indigenous societies found themselves confronted with European institutions which though have different success rates in different parts of the world. Thus, in most of the independent colonized countries, the origins of the existing institutional framework can be traced back to the colonial periods. Engerman and Sokoloff (2000) examined the importance of factor endowments and colonial rule for the subsequent economic development of colonies within the Americas. They concluded that in societies founded with greater inequality, the elites gained more

[1] According to Seidler (2011), colonization offers a fascinating field to institutional economics, because it provides something like a "natural experiment" in history.

power to influence the choice of legal and economic institutions. This path of institutional development might, in turn, have affected growth.

Second, Acemoglu *et al.,* (2001) argued that Europeans adopted different institutions in different colonies, depending on the settler mortality rates in the colonies. 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. Their adopted institutions persisted still in the independent countries which, in turn, explain the cross-country differences in growth performance. In a related study, Acemoglu *et al.,* (2002) maintained that Europeans introduced extractive institutions in prosperous and densely settled areas by exploiting the existing traditional institutions to force the local population to work in mines and plantations. In contrast, in sparsely settled areas, Eurpoeans 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.

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 been central to economic development. Similarly, La Porta *et al.,* (1999) as well as Djankov *et al.,* (2003) examined the importance of colonial rule, but they focused on the legal institutions that were transplanted by the different colonial powers. They concluded that 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 experienced good institutional framework relative to those of the French.

All the three factors discussed in the above literature, *i.e.* the initial inequality, the settler mortality rates, and the legal traditions were largely exogenous to the colonized countries. In this study, our approach is different from the above studies in that we focus on a particular case study rather than cross-country comparison. Second, we provide a broad picture to alienate the impact of colonization on Nigerian institutions from other endogenous and indigenous foundations. British control over today's Nigeria was achieved in a gradual process. Started from the colonization of the settlement of Lagos in 1861, the British extended its colonization to other parts of Nigeria with the passage of time. For instance, 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. The killing of the Sultan of Sokoto, Caliph Attahiru I, in 1903 abolished the caliphate as a sovereign political formation (International Crisis Group (ICG), 2010). 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.[1]

Onwards 1900 to Independence, the British applied the policy of indirect rule, especially in the Northern Nigeria.[2] This practice involved restructuring local traditional authorities and institutions and deposing those office holders who resisted. This made a compliant local power base that furthered British interests. 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. Local rulers were used to control the populace and raise revenue but were supervised by British officials who could veto their decisions.[3] Although they restructured many emirate

[1] 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.

[2] Indirect rule basically meant that existing political hierarchies were remodeled into units of local self-government that fitted into the British colonial administration. Existing traditional political leaders (Emirs, Shehus, chiefs etc.) were to govern their people, not as independent but as dependent rulers. At least in theory, the attitude of the British officials was that of a watchful adviser not as interfering ruler (Crowder 1978:199-200).

[3] According to Seidler (2011), only the treasury, railways, judiciary, military and post

authorities, seeking more compliant office holders, the British also sought to avoid any direct disruption of the region's social structures, including its dominant religion and culture. For instance, although the British controlled Nigeria completely by 1914 but the custom of slave owning remained intact until 1936.

However, the British adopted the administrative set up along a centralized and hierarchical structure. This system involved direct and strong control, as it required that all personnel remain unquestionably. Subordinate to top (colonial) authority. [1] Although the hierarchical structure was characterized by tidiness and order in the work place, but it destructively disrupted personal initiatives, creative thinking and innovation among the local people. So, 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.[2] Thus, 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.

In terms of economic structure, the British rule formed a classic open economy characterized by the exportation of agricultural

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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.

[1] 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 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.

[2] 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.

commodities and solid minerals, and the importation of foreign manufactured goods. Notwithstanding Britain's reputation of the guardian of economic liberalism, the colonial administration substantially intervened in the economy. Government authorities established several public enterprises in infrastructure, production and commerce. Additionally, it officially regulated trade in major commodities. The main focus was on the development of international trade as state revenue mainly derived from the taxation of trade. Domestic markets developed mainly in areas which were off the international linkages and exports centres. Given this colonial policy and the earlier agrarian structure of Nigeria, all activities were directed at subsistence farming. Commercial production was carried out only for exports and it was carried out in those sectors which were of interests to British business firms.[1] As a result, No genuine effort was made towards developing the technical and managerial capacity of the local farmers beyond that of being mere producers of primary products or raw materials. This policy also limited the development of manufacturing sector, confining it to labour-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. Beginning with the Richard's constitution in 1947, Nigeria formally got the federal structure in the Lyttleton constitution in 1954. The regional divide into Northern, South Eastern and South Western parts of Nigeria laid out a roadmap for self-rule.[2] The regions were granted autonomy over internal policy and

[1] International trade was in the hands of few European firms like United Africa Company (UAC), Lever Brothers, Pamol Plantation, PZ Cussons, SCOA, etc. However, these foreign firms transferred the policies and business practices prevalent in their home countries but it had a detrimental effect on the development of Nigerian-originated management policies and theories. Similarly, in banking, the colonial administration promoted and sustained the business interests of British Bank for West Africa (now First Bank, Public Limited Company), Anglo-African Bank and Colonial Bank (now Union Bank, Public Limited Company) to the exclusion of all indigenous banking initiatives, prominently including Industrial Commercial Bank (established in 1929) and Nigerian Mercantile Bank (established in 1931) – both squeezed out of business and into premature liquidation by unfavorable market conditions.

[2] After thorough consultations at the village, district, provincial, regional and national levels, federalism was viewed as the best way to address the strong demand for regional autonomy.

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 legislature on the basis of regional population. This provided the Northern region with an edge in the Westminster model of 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. Consequently, Sir Abubakar Tafawa Balewa, the deputy leader of NPC, became prime minister in the new independent administration. 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. Given the initial set of ethnic rivalries, this policy led to the enhanced ethnic competition for controlling the federal government. 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.

5. Ethnic Fragmentation, Biafra War and Institutions

An ethnic group is a community whose heritage offers important characteristics in common between its members and which makes them distinct from other communities. To discuss ethnicity in terms of the evolution of Nigerian institutions and the corresponding economic outcomes, we use an operational definition of ethnicity by (Osaghae, 1995). According to (Osaghae, 1995: 11), ethnicity may be defined as "the employment or mobilization of ethnic identity and difference to gain advantage in situations of competition, conflict or cooperation". This definition highlights two characteristics of ethnicity: first, ethnicity is neither natural nor accidental but is the product of a conscious effort by social actors; second, ethnicity is not only manifested in conflictive or competitive relations but also in the contexts of cooperation. A corollary to the second point is that ethnic conflict manifests itself in various forms, including voting, community service and violence (Horowitz, 1985).

The impact of ethno-linguistic fragmentation for economic outcomes has been initiated with the influential studies of Mauro (1995), and Easterly and Levine (1997). Mauro (1995), using ethno-linguistic fragmentation as an instrument for corruption, argued that ethno-linguistic fragmentation matters for government activities and economic outcomes. Subsequently, based on cross-country analysis, Easterly and Levine (1997) have shown that per capita GDP growth is inversely related to ethno-linguistic fractionalization. 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. Similarly, 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). Most of these studies give the institutional explanation of ethnicity and suggest the possible three channels: political instability, rent-seeking policies and generalized corruption, and under provision of public goods (Mauro, 1995; Easterly and Levine, 1997; La Porta et al., 1999; Alesina *et al.*, 2003; and Montalvo and Reynal-Querol, 2005a). This study is similar to the earlier research in one aspect because our approach is based on the institutional perspective of ethnic diversity. However, it is different in that our evidence is based on a case study instead of cross-country data.

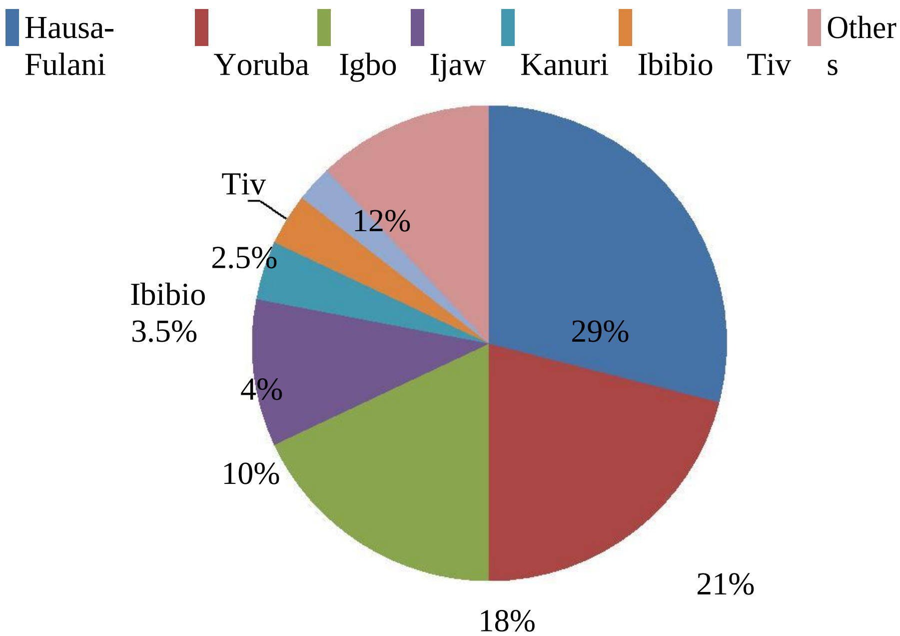
The evolution of ethnic identities or regional cleavages in Nigeria can be traced back to structures consolidated by the colonialists in the process of combining Nigeria. The ethnicity-based division originated from the colonial divide of Nigeria into the North and the South which were administered separately, even after the two units were amalgamated in 1914. These cleavages strengthened further 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 political process 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[1]; the Yoruba (21 percent) is in the southwest; and the Ibo

[1] A fourth region, Mid-West, was created in 1963, but partly because of its status as home

(Igbo) (18 percent) reside in the southeast. The three dominant groups are divided by the Niger and Benue Rivers. 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).

Figure 2: Ethnic Groups as Percentage of Population



Source: CIA Factbook, 2010.

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.[21] Divided by regions and ethnicities, the population speaks close to 400 different languages and dialects. Alongside the ethno-linguistic fragmentations, the politically salient groups are also characterized by different economic interests and endowments since the colonial times.[1] For instance, the South was highly

to minorities, the creation did not fundamentally alter the tripartite regional structure existing before the First Republic was sacked by the military in 1966.

[1] According to Lewis (2007:54) The Muslims are predominantly in the North, and account for about 50% of the population, while about 45% of the population is Christian

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 isolated due to their traditional emirate rule. Therefore, they lost the opportunity to develop at the same speed as did the South. At the time of independence, this uneven level of development was present.[1]

However, the comparative advantage given to the Northerners by the constitutional settlement of 1957 and their population paralleled their earlier disadvantage in education and economic position. Since then, given their post-independence skills in forming political coalitions, they have dominated the central government.[2]

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 the opposition party. 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.[3] This agenda resulted in a feeling of marginalization and discrimination amongst the eastern Igbos. Consequently, the Christian Igbo officers revolted that was manifested in the January, 1966 coup in which Ahmadu Bello, the chief of NPC and several northern political and military leaders were killed. This was followed by a counter-coup in July, 1966 by the Northerners that resulted

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which is mostly in the Southern parts. The last 5% are regarded as practicing „traditional‟ religions.

[1] According to Lewis (2007), export production of coca and palm oil pre-dominated in the South Western region, palm produce was prevalent in the South Eastern Region and groundnuts and cotton were crucial in the Northern region. Minerals like limestone, tin and iron ore were randomly distributed.

[2] 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.

[3] 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

in the mass killings of southeasterners, mostly Igbos. Thousands of them flee back to safety in the South (Aleman & Treisman 2005: 199).

The failure of the First Republic arose mainly from tensions between federal institutions, parliamentary rule and invidious communal competition. For instance, it was the dissatisfaction from the federal structure that resulted in the secession of Igbo-dominated Eastern Region in May, 1967. This discontent, enhanced by ethnic competition, was manifested in Biafra Civil war (May, 1967 to January, 1970) in which the communities in south-eastern Nigeria, dominated by Igbo, declared itself as the Republic of Biafra.[1] The war was mostly fought in the eastern regions, and it was concluded in favour of the Nigeria 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. Consequently, this led to an increase of personnel in the army from the north. Many northern youth enlisted in the army, which expanded from 10,000 in 1967 to 250,000 in 1970 (International Crisis Group, 2010).

Second, it intensified further the salience of ethnicity in 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.[2] 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

[1] The Yoruba party‟s chieftain, Obafemi Awolowo feeling marginalized tried to forcefully overthrow the federal government. His coup failed and he was arrested, charged with treason, tried and sent to ten year prison term. However, the coalition of NPC and NCNC turned the government into the game of corruption. As a result, on January 15, 1966, the military under the leadership of Major Nzeogwu over threw the Federal Government.

[2] 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.

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.

6. 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 onwards research, relying on the reduced-form relationship between natural resources rents and economic outcomes, gives the explanation incorporated in the Dutch Disease, *i.e.* the windfalls crowd out the manufacturing sector.[1] However, as the institutional explanation of cross-country development gaps arose; interests in the implications of natural resources for institutions also took surge (Khan, 1994; Leite and Weidmann, 1999; Tornell and Lane, 1999; Ross, 2001; Torvik, 2002; Sala-i-Martin and Subramanian, 2003). Most of this research is based on the corruption and rent-seeking perspective of natural resources. For instance, Leite and Weidmann (1999) conclude that the rent-seeking behaviour associated with windfalls gains may spawn corruption, which subsequently may impact economic growth. Similarly, Khan (1994) attributes Nigeria's poor economic performance to corruption induced by the oil boom. Tornell and Lane (1999), further, establish that natural resources as rents lead to voracious rent-seeking which, in turn, shape the formal political and economic structure. Their „voracity effect‟ implies that countries with many interest groups competing for the resources rents are likely to overspend in good years, and under adjust in bad years. Torvik (2002) arrived at similar conclusion by illustrating that profitable rent seeking activities diverts entrepreneurial activity away from manufacturing. Successful rent-seeking, in turn, results in the concentration of economic and political power in the hands of the privileged groups. Subsequently, this power is used to maintain or enhance the power further, which usually results in persistent inequality, poor

[1] Nigeria is divided into 36 states in a gradual process. States expanded from 4 to 12 in 1967, to 19 in 1976 and finally to 36 in 1996.

democracies and political instability. Finally, there is also a view that civil wars and natural resources are associated that is the availability of resources increases the possibility of civil wars (Collier and Hoeffler, 1998; Fearon and Laitin, 2003; De Soysa, 2002; Ross, 2001).

In case of Nigeria, both of these views can be regarded as relevant because Nigeria experienced both civil conflicts and extreme rent-seeking during the windfalls. For instance, the Biafra war was partly arose because of the competition between the Northerners and the South-Easterners for resources. Similarly, corruption and rent-seeking is manifested in the populist measures during the windfalls periods. 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). All of these policies enhanced opportunities for corruption and rent-seeking. Thus, Nigeria can be thought of as a country especially vulnerable to what amounts to an equivalent of overgrazing the common.

Oil was discovered in the Niger River delta, located on the south eastern part of Nigeria, in 1956. At that time Nigeria was a low-income agrarian economy specializing mostly on a range of primary agricultural commodities like coca, palm produce, ground nuts and rubber. Also, it had stable terms of trade with stable mineral exports (including coal, limestone, and tin) that augmented export income. In the beginning, although 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 by creating Nigerian National Oil Corporation (NNOC) via a decree in 1971.

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.[1] This was a major windfall for an underdeveloped country. These windfalls have led to the high concentration of Nigerian economy into petroleum sector. In order to demonstrate this fact, we analyze the importance of oil revenue and the trends in public expenditure during the windfalls.

A glance at table 3 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 exports earnings.

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

Table 3: 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.

Apart from its economic importance, oil is also important politically. The federal government redistributes a significant share of the oil revenues to Nigeria's 36 states and 776 local governments, which have become highly dependent on this source of income (Bach, 2006). Since the nationalization of oil sector in 1971, the distribution of the oil revenue across various regions has been undertaken by the federal government.[1] Most of the Nigerian states have no independent source of revenue and

[1] The Middle Eastern Yom Kippur war, also called Ramadan war, is the fourth Arab-Israeli war which was fought from October, 6 to 25, 1973. The Arabs coalition was leading by the Egypt and the Syria. This war was one of the major causes oil prices shock in 1973. This is because the oil exporting Arab countries proclaimed oil embargo. This was in response to the U.S. decision to re-supply the Israeli military during the Yom Kippur War.

thereby, cannot support themselves.[1] They look to the federation to obtain revenue with which to finance their current as well as development expenditure. Throughout the Nigerian independent history, the central government has been formed by multi-ethnic coalitions. So, it has been merely a stage for the collection and the distribution of oil revenue. Ethnic groups with more bargaining power obtain greater share of this national treasure. Consequently, these windfalls have long lasting effects on the evolution of Nigerian institutions. For instance, the distributional conflict has resulted in frequent changes in the revenue sharing formula. As can be seen in table 4, 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: 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

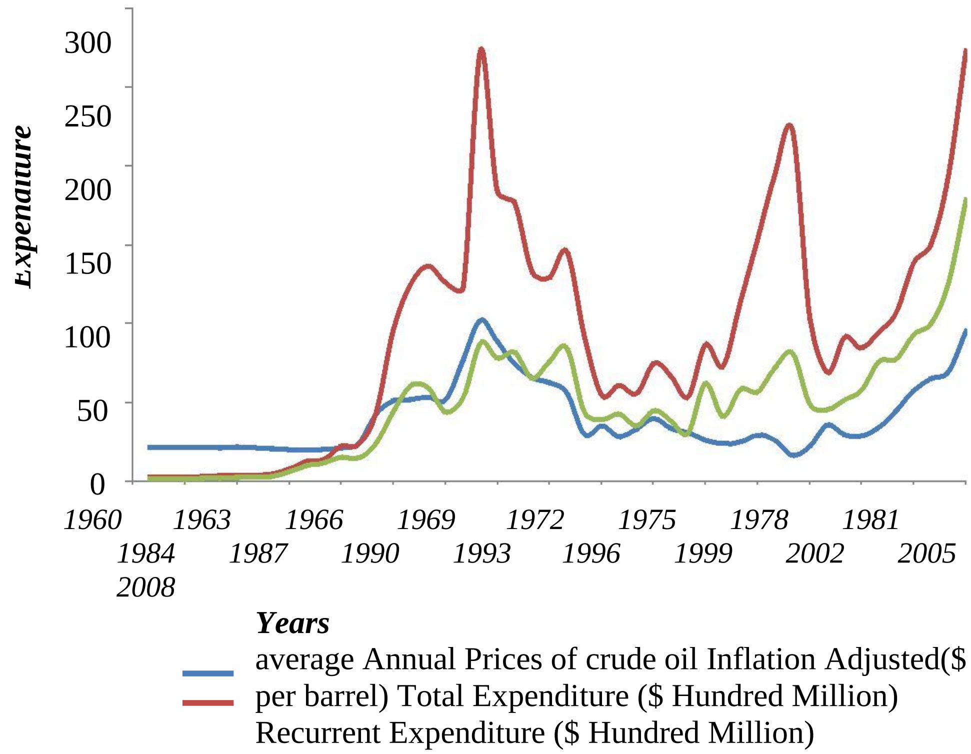
Source: Salami (2011)

** 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 1 and summarized in details in table 5 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

[1] In Nigeria, resources rents accrued directly to the central government, fostering a marked centralization of fiscal policy and a growth in the economic role of state. In addition, government revenue was essentially divorced from a domestic tax base, which reduced accountability and dampened incentives to promote local production.

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.[1] 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.



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

[1] The internal taxation systems in these states are not efficient and cannot generate enough revenue. Most of the citizens of these states even don't pay taxes. Ethnic groups in the form of states compete for their share in the windfalls.

It is estimated that Nigerian capital stock grew at an average of 14 percent per year from 1973 to 1980. Although, Nigeria over-invested in physical capital after the surge in oil revenues, but it suffered from poor productivity. Sala-i-Martin and Subramanian (2003) calculate a negative TFP growth since 1965. In the same way, the capacity utilization rate for Nigeria, on average, is roughly between 35% and 40%, indicating that almost two-third of the investment in manufacturing is continuously wasted (Sala-i-Martin and Subramanian, 2003). Similarly, 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. Nigeria is thus specializing in something in which it has a disadvantage.[1]

The major impetus for the rise in public expenditure was an attempt by the actors involved in the federal structure to capture these rents in terms of corruption and kickbacks on contracts. For instance, in the 1970s, one of the decisions was to build a steel industry so that local coke and iron ore could be transformed into shiny metal, which would then be used to build railways. Thus, oil revenues financed the building of the famous Ajakouta steel complex in the 1970s at the cost of $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.[2] In the same way, in 1978, once the civilian government was installed, one of its first decisions was to recall a contract for a dam which had been awarded at the price of $120 million and re-award it at the astonishingly inflated cost of $600 million (Bevan *et al*., 1999).

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

[1] In1986, Nigerian society faced double shocks: the world oil price crashed from $30 to $18, and there was a swing from borrowing to repaying the external debt. The debt shock was as large as the oil shock. Between them these two shocks roughly halved per capita real expenditure.
[2] The rapid buildup of oil revenue allowed the government to finance interventions without raising taxes or reallocating existing expenditures.

establishment of subsidies on services and basic commodities.[1] The capital projects in the public sector increased the discretionary funds of bureaucrats which, in turn, led to their increased influence in the society. The absence of fiscal oversight and the lack of accountability encouraged public officials to regard their offices as sinecures for extracting state resources. Also, it resulted in the increased lobbying of interest groups over the location and control of these projects. The income inequality increased drastically as the elites utilized these conditions to construct or solidify networks, along with the impulse to advance personal accumulation. Additionally, politicians and civil servants were widely involved in business activities which blurred the distinction between the government and the private interests. Thus, accumulation was structured around the collusion between businesses and state elites.

7. Interaction between Colonization, Ethnicity and Windfalls

We have demonstrated above that the Nigerian formal institutional framework has been evolved under colonial legacy, social divide and windfalls. In this section, we explore the interaction between these three features which is summarized in figure 4. The first and most important factor that shapes Nigerian institutions is its social divide. According to instrumental view of ethnicity, ethnic identities serve as an instrument of claiming resources or defending perceived material interests for groups adhered to those identities. Based on this view, most of the earlier research on ethnic politics in Nigeria has established that communal politics is a struggle among fixed identity groups who contend over scarce resources (Nnoli, 1978, 1995). Thus, ethnicity serves is a central avenue for collective action because it offers a way for political organization and participation. The resulting regimes have an ethnic character. In the same way, the military regimes reflect a clear sectional ruling group. In both types of governments, rules have never been followed in the distributive contest among various groups. Similarly, political control has been established through clientelist networks and patronage systems. These assertions construct causality from ethnicity to institutional framework which, in turn, has caused underdevelopment in Nigeria. It is well-established that politics, shaped by ethnicity, result in the instability of

[1] Nigerian decision-makers wanted a steel industry whatever the cost, partly as a matter of national pride, and partly because big projects brought big kickbacks.

institutional framework (Diamond *et al.*, 1995).[1]

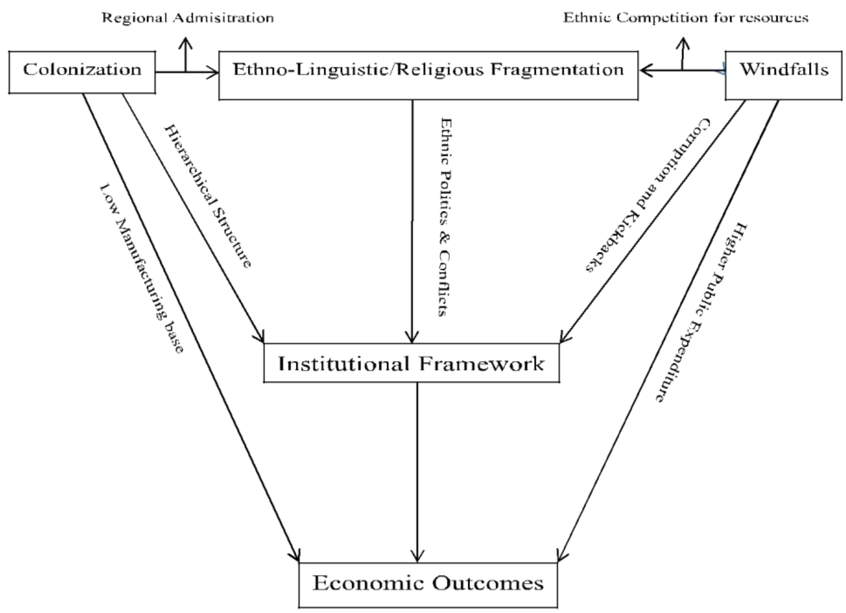
The second factor that is relevant for poor institutional order in Nigeria is its colonial legacy. In the colonial administration, the British officials were involved down to district level. Local suzerains were *de facto* salaried functionaries of the British administration. They were paid a fixed income 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. In the inherited bureaucratic structure, Public officials in Nigeria have been ruling instead of serving.

Second, British's colonial economic policy was oriented towards international trade. The trade structure, ensuring the business interests of the European firms, was established in such a way that Nigeria could only export raw materials and import manufacturing goods. Thus, 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. The British perpetuated cultural differences by incorporating and exploiting traditional political institutions into the colonial system. 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 strengthened ethnic identification and consciousness. It 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 by-product, their different administration for the North and South led to wide differences in the regions in terms of education, modernization and economic outcomes.[2]

[1] According to Lewis (2007), state-owned enterprises expanded from 250 in 1970 to more than 800 by 1980.

[2] 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.

Figure 4: An Interaction between Colonization, Ethnicity and Windfalls



Source: Own Assessment

Finally, successive colonial constitutions devised for Nigeria entrenched the *de jure* political power on regional lines. From 1951 to 1958, Britain ensured that half of the seats in the Federal Parliament were allocated to the North.[1] The British followed the policy of North's domination deliberately as the strategy was to „divide and rule‟. For instance, they failed to break up the North into several regions in that all the colonial administration actively encouraged the Northern Peoples‟

Congress to resist the creation of new regions in the North. The British felt that they had a lot in common with the Hausa Fulani

[1] The indirect rule in the North deliberately preserved the Muslim culture and impeded Christian missionary influence and modern education. This, in turn, became a barrier to modernization in the North. The South on the other hand which comprise the Yoruba of the West, the Ibo of the East, and other smaller peoples, was an area in which colonial rule involved a fairly strong westernizing influence, Christian missionary effort, and an education fashioned on the English model.

aristocracy than with the restless and nationalists in the South. Because of this, they wished that their interests in Nigeria would be better protected by the northerners, long after their departure from the country.

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. We have shown above that the distributional politics has weakened the Nigerian formal structure. For instance, it expanded the clientalists networks and prebendalism.[1]

Besides, the distributional conflict makes the allocation function more complex. This is shown by the fact that 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. Periodic oil booms filled state coffers with windfalls in billions which led to the promotion of statism mentality. The expanded role of state, in turn, opened opportunities for unbridled corruption and profligacy in the process of national spending on industrialization and infrastructure projects. New domains of rent-seeking were created by state investments, contracts, trade and currency controls, and indigenization transfer. Entrepreneurs secured rents by colliding 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.

8. Conclusion

In this study, we have endeavoured to explain the interaction between rent-seeking, institutions and economic outcomes by providing evidence from Nigeria. After independence, Nigeria was expected to have

[1] The House of Representatives, it was laid down, would be elected on the basis of population figures. And since the North had over half of Nigeria's population, and three times the land territory of the other two regions combined, it was thus guaranteed cast-iron political domination of the country.

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, inefficient institutional framework and poor economic outcomes. The main proximate factors that may 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.

The inefficiency of formal institutional framework may be regarded as the fundamental cause leading to higher concentration on oil and lower manufacturing base. Nigeria's formal institutions, in turn, have 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, were non-ideological, non-participatory and were mainly comprised rent-seeking policies. The rulers did not compete for support on the basis of their beliefs or social welfare but rather; they competed on the basis of loyalties or interests. Social diversity was vehemently used in politics by all the rulers including colonizers, military and civilian ones. Consequently, 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, in turn, led to increased rent-seeking and kick-backs on contracts.

In Nigeria, since the colonial times, the balance of power between citizens and state actors have been skewed in favor of officials, so access to state has been corresponding to access to the state revenues.

This perpetuates politics, even democratic politics, as well as administration as patronage. In terms of path dependence, this 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 inefficient institutional framework. Second, focusing on the three foundations of the Nigerian institutions, we have found that no single factor can explains the persistence of inefficient 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, inefficient 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.

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 the availability of data.

Table 5: 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

Source: 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 2: 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				"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

Accountability	-1.80	-0.72	-0.60	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.

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