

1 Cost of Governance on Economic Development in Nigeria

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6 **Abstract**

7 The study aims at investigating the impact of cost of governance on economic development in
8 Nigeria. Cost of governance is captured by recurrent and capital administrative expenditures,
9 while gross domestic product is used as a proxy for economic growth. Using data from 1970 to
10 2010 and the Ordinary Least Squares (OLS) technique of analysis, the study reveals that cost
11 of governance hampers economic development in Nigeria. Therefore, there is the need to place
12 institutional constraints on public office holders and technocrats in order to minimize the
13 extraction of rent from the state and enhance the availability of public funds for development
14 projects and vital sectors of the economy

15

16 **Index terms**— Nigeria, weak Institutions, Economic Development, Governance.

17 **1 Introduction**

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

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

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

31 Correspondingly, the drastic fall in the price of crude oil in the early 1980s equally raised the proportion of
32 the budget apportioned to recurrent expenditure.

33 Though there was a decline in the proportion of the budget allocated to recurrent expenditure, from 60.10%
34 in 1990 to 36.56% in 1998, it has since risen to 80.29% in 2003. The justification for using recurrent expenditure
35 as a percentage of total budget as an important indicator of the cost of governance stems from the belief that
36 capital expenditure impacts more positively on the economy in respect to employment, investment and other
37 growth-inducing activities (Adewole and Osabuohien, 2007).

38 Total administrative expenditure as a percentage of gross domestic product (GDP) was a high as 8.72% in
39 1977 but fell to an all time low of 2.04% in 2002. According to Adewole and Osabuohien (2007), if we assumed
40 that government administrative expenditure supports the GDP of any given society, then an administrative
41 expenditure of nearly 9 kobo went into the production of N1 worth of goods and services for the period of 1977
42 to 2002.

43 Over the subsequent years, the administrative costs of producing N1 worth of goods and services fell to 2 kobo
44 in 1989. It rose to 4 kobo in 1999 and then to 7 kobo in 2002. According to Haber (2004), much of the high costs
45 of governance are largely due to the absence of institutional structures that direct attention away from predation

4 B) ECONOMIC THEORY OF THE STATE AND THE COST OF GOVERNANCE

46 to production. When the primary function of the state is essentially redistributive or predatory, productive
47 activities become less significant as a driving force of economic activities. It is against this background that
48 this empirical work is motivated to analyze the effects of the continuous rise in costs of governance on economic
49 development in Nigeria.

50 2 II.

51 3 Literature Review a) The Cost of Governance

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

57 Similarly, Fluvian (2006) defined cost of governance as any expenditure in maintaining which is a part of
58 total federal government expenditure in Nigeria. He said that the justification for using total administrative
59 expenditure as cost of governance stems from the fact that administrative expenditures are incurred in governing
60 processes.

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

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

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

78 4 b) Economic Theory of the State and the Cost of Governance

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

84 Thus, weak institutions, amply represented by growth -inhibiting political structures, became the dominate
85 feature of resource rich multi-ethnic societies. Afolugbo, et al (??004) added that the opportunistic behaviour of
86 ethnic leaders, particularly in a mineral-rich polity such as Nigeria, eventually produced a government structure
87 that had a negative toll on social and economic progress.

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

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

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

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

104 From a political economy perspective, the state is the by -product of rational individuals who believe that
105 state formation would be better than living as individual or families. The state, therefore, as well as being the

106 government's instrument of operation, is a natural monopoly, for no two organizations with equal powers of force
107 over a defined territory can co-exist successfully and maintain relative peace.

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

114 c) The Rising Cost of Governance in Nigeria Governance represents more than a means of providing common
115 good, as it can be related to the government capacity to help the citizens ability to achieve individual satisfaction
116 and material prosperity. Therefore, governance could be compared to the management, supply and delivery of
117 public services to a nation.

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

122 Similarly, the issue of misuse of public funds is another cause of the rising cost of governance in Nigeria
123 ??Warimen, 2007). Political leaders inflate the costs of public projects to embellish themselves. Adewole and
124 Osabuohien (2007) also said that the supply of security beyond the optimal level will lead to limited prosperity. In
125 other words, the excess money spent by government on a particular set goods affects development, since resources
126 are scarce and should be optimally utilized. Furthermore, there is population increase. An increase in population
127 implies that there is pressure in the limited available the resources. Fluvian (2006) also said that increase in population
128 implies that more demand for public goods and services, such as education, health services, etc. the
129 need to give every ethnic group adequate representation is another reason for increasing cost of governance.

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

134 5 III.

135 6 Theoretical Framework

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

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

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

149 To enhance growth and development, governance must be cost-effective and the civil service sector must be
150 efficient; and there must be increasing investment of public funds in productive sectors of the economy. The
151 civil service sector must be reduced to manageable but optimal size. In Nigeria, the civil service sector is extra
152 large with gross inefficiency and exorbitant cost to the government. When a state is constituted properly it is
153 possible for the society to end up with an optimal mix of both public and private goods that will maximize social
154 welfare. For economic efficiency, private goods can be more cheaply provided by private firms and public goods
155 by a collective organization -the government.

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

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

10 VI. CONCLUSION AND RECOMMENDATIONS

165 7 IV.

166 8 Model Specification

167 A general growth model is specified in the study. Gross domestic product is used as a proxy for economic
168 development; while cost of governance is captured by total administrative expenditure, which is decomposed
169 into recurrent administrative expenditure and capital administrative expenditure. The model can, therefore, be
170 specified thus:Year GDP = f(DEX, CEX) - - - (1)

171) Put in an explicit form, the above model becomes:GDP = ? 0 + ? 1 REX + ? 2 CEX + u 1 - - - (2)

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

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

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

183 V.

184 9 Discussion Of Findings

185 The result obtained from the analysis is presented below:- From the above result, a unit rise in recurrent
186 administrative expenditure will lead to 0.52 unit fall in gross domestic product; while a unit rise in capital
187 administrative expenditure will cause gross domestic product to fall by 0.45 unit. This is in line with the
188 theoretical expectations, both recurrent and capital administrative expenditures have negative impact on gross
189 domestic product.GDP = 2.

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

196 The coefficient of determination (0.93) indicates that 93% of the variations in gross domestic product is
197 explained by both recurrent and capital expenditure. In other words, 93% of the variations in gross domestic
198 product is caused by cost of governance. The F-statistic (259.73) is greater than the f-critical value ??3.23), at the
199 5% level of significance. This implies that both recurrent and capital administrative expenditures are statistically
200 significant in explaining changes in gross domestic product. This also indicates that the overall fitness of the
201 model is good.

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

204 10 VI. Conclusion And Recommendations

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

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

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

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

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

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

224 Also, Public funds should be judiciously utilized. In other words, every naira of public funds showed be spent
225 to maximize social welfare. A huge proportion of Y Where, $? 1 < 0$ and $? 2 < 0$ government revenue should be
226 expended on development projects and in vital sectors of the economy, such as agricultural and manufacturing
227 sectors.

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

232 There should be an optimal cabinet size to reduce cost of governance. The larger than optimal size of the
233 executive cabinet and civil service sector are major causes of increasing cost of governance in Nigeria. It has also
234 led to inefficiency in the public sector and waste of public fund.^{1 2}

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