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The Impact of Poor Institutional Quality and Public Debt on Economic Growth in Nigeria

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Abstract

Poor institutional quality and public debt has tremendous impact on economic growth in Nigeria from 2000 to 2021, sourced from WDI and CBN statistical bulletin. The study is anchored on endogenous growth model and by using Auto-Regressive Distributed Lag (ARDL) model. The variables used are GDP growth rate, while poor governance (PG), corruption perception index (CPI) and public debt (PD) are the explanatory variables. The result from the ARDL Bound test revealed that there exists long run relationship among the variables. From the ARDL estimate, Poor governance was found to have significant impact on economic growth in Nigeria, both in the long run and the short run. Corruption perception index was found to have a negative impact on economic growth in Nigeria in the long run and in the short run. Public debt was found to have a significant adverse impact on economic growth in the long run but not significant in the short run. The findings reveal that inadequate institutional frameworks significantly hinder economic growth, while escalating public debt imposes constraints on fiscal policies, thus further undermining growth prospects. The policy recommendations aimed at improving institutional quality and managing public debt to foster sustainable economic growth in Nigeria.

Keywords: *Economic Growth, Governance, Institutional Quality, Public Debt*

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Background to the Study

Strong institutions promote macroeconomic stability and social cohesiveness, which boost investment and economic growth (Utile, Ijirshar & Sem, 2021). According to Abubakar (2020) nations with robust institutions support robust legal frameworks for effective funding mobilization and allocation, which lowers the risk of doing business in those nations. Study has moreover underscored the significance of robust institutional quality in sustaining expansion and advancement (Iheonu, Ihedimma, & 2017; Parks, Buntaine & Buch, 2017). Inadequate institutional governance or a lack of institutional control has increased the cost of investment in Sub-Saharan African (SSA) nations like Nigeria (Iyoboyi, & Pedro, 2014). Due to the high expenses of investment, the uncertainty brought about by tax enforcement of laws and regulations, and the inefficiency of the legal system, businesses have been compelled to become more selective about where they place their money. According to Anna (2018), Nigeria's institutional quality has historically been poorly documented in terms of the country's ability to protect property rights, the degree to which laws and regulations are not applied fairly because of a high level of corruption, the country's voice and accountability, political instability, terrorism, and government efficacy (Ugwuanyi & Eze, 2023).

According to Muhammad & Charles (2018), low institutional quality can result in unnecessarily high costs associated with conducting business in a highly corrupt economy. This is because low institutional quality can be seen in the corruption of civil servants, bureaucracy, and high levels of extortion. These factors can spawn mistrust, which can be unhealthy for doing business for both domestic and foreign investors. Furthermore, the lack of clear definition of property rights may result in significant risks of expropriation, discouraging investors from patenting their inventions to small businesses (Ebekozien, Ugochukwu, & Okoye, 2015).

Efobi & Osabuohien (2011) argued that, poor economic performance in most African countries is attributable to various factors including poor governance and poor institutional quality, amongst others. They further argue that the global financial crisis left many countries including African countries vulnerable and it brought up the importance of strong institutional quality to the fore. According to Zubair (2023) institutional quality matters as it ensures that debt is managed efficiently and poor institutions are likely to impair borrowing decisions and divert the borrowed funds to "fruitless" projects. About five SADC countries are heavily indebted and poor institutional quality in developing countries is used to explain why some of these countries are heavily indebted (Abdullahi, et al., 2019). Understanding the implication that public debt displays on the rate of growth is key mostly to policymakers who deal with growing fiscal imbalances (Mojapelo, 2020). Even more, determining the aftermath of the national debt on the economy stands indispensable because it directly concerns existing taxpayers, the future generation and can ultimately affect expectations about the future (Georgiev, 2012). The synergy between poor institutional quality and escalating public debt raises critical questions about Nigeria's economic stability and growth potential. As public debt accumulates, limited fiscal space restricts necessary investments in infrastructure and social services, while inadequate governance exacerbates inefficiencies.

Given Nigeria's declining institutional quality, the country's economic growth has become highly precarious. Available literature has shown that institutions are viewed as a basic requirement for economic success and long-term progress and that institutional quality consists of a broad range of factors, some of which are hard to measure (Zubair, 2018). More importantly, while there is widespread agreement that the quality of institutions and economic growth are inextricably related, the relevant economic literature is divided on the exact nature of this relationship (Bruinshoofd, 2016). Hope (2017) posited that institutional quality indicators is inversely related to economic performance. Poor institutional quality reduces human capital, discourage investors, and the multiplier effects transmit into low productivity and low private investment, which translate into poor economic performance (Khan &Naeem, 2020). Even though the common consensus is that institutional quality is more likely to promote economic growth than the reverse direction of causality, it must be re-examined empirically, hence the need for this study. Therefore, the broad objectives of this study are to examine the relationship between institutional quality and public debt on economic growth in Nigeria. The specific objectives are to:

i. Assess the current state of institutional quality and public debt in Nigeria.
ii. Examine the relationship between institutional quality, public debt, and economic growth.
iii. Provide policy recommendations to address the challenges posed by poor institutional quality and high public debt.

Literature Review

Institutional Quality

Institutional quality refers to the effectiveness and integrity of institutions in governance, law enforcement, and public administration. According to North (1990), institutions shape economic performance by defining the rules of the game and determining how resources are allocated. Promoting financial inclusion and effective mobile money system depends on quality institutions (Zubair,et al 2024). Quality institutions promote financial access through inclusive policies (Sanga & Aziakpono, 2022; Balach & Law, 2015; Djankov et al., 2006). Poor institutional quality undermines investor confidence, hampers economic activities, and fosters a culture of corruption. Institutions reduce financial intermediation process by providing stable financial environment that support banks core functions of liquidity creation, and thus improves bank intermediation function of credit (Marcelin and Mathur, 2014). Zeqiraj et al. (2022) find that development in institutions is key ingredient for social progress and welfare. Zubair. (2021) on the effect of institutional matters on economic conditions, argue that it is "quality" institutions that matters. Countries with extractive institutions in the form of insecure property rights and distortionary policies have disproportionately income distribution, whereas countries with "better" institutions or inclusive institutions achieve higher income (Zubair et al., 2025). Therefore, institutional failures would constitute market exclusion, inefficiency, resource misallocation, and lead to more deprivation and financial exclusion (Acemoglu et al., 2021; North, 1990; Haselmann & Wachtel, 2010; Troilo et al., 2019) Institutions issue.

Concept of Public Debt

The total amount of money borrowed by the government and local authorities to cover their budget deficits is referred to as the government, public, or national debt, according to Mishkin (2013). Thus, up to a certain amount, the real budget deficit is equal to the amount of government debt. The amount of government debt is often stated as a percentage of GDP to facilitate understanding. Local lenders' loans are classified as domestic debts, whereas foreign lenders' loans are classified as external debts. The government prints bonds in order to borrow funds from companies and private citizens. Since the government can increase taxes or create new money to cover the principal and interest on government bonds when they mature, bonds issued in local currency are regarded as credit-free. Due to the possibility of exchange rate risk and the likelihood that the government may not have enough foreign currency to service its debts, foreign government bonds frequently carry a larger credit risk than local government bonds (Nguyen, 2023).

Concept of Economic Growth

The term "economic growth" typically refers to an increase in the market value of the goods and services generated by an economy over time, adjusted for inflation. It is measured as the rate of growth in real GDP, typically expressed in terms of per capita. Growth usually is calculated in real terms, that is, inflation-adjusted terms. Economic growth also means increased growth in the level of output produced by a country over time and it crucially measures the economic performance of a country. Jhingan (2002) defines economic growth as a mechanism through which real per capita income of an economy rises over a long period of time. He states that economic growth is determined by the rise in the quantity of commodities and services through time. Therefore, an economy experiences growth as its productive capacity rises, which is then employed to produce additional commodities and services.

The Interplay Between Institutional Quality, Public Debt, and Economic Growth

The literature highlights a significant relationship between institutional quality, public debt, and economic growth. Poor institutions can lead to mismanagement of public resources, resulting in excessive borrowing to cover deficits (King & Levine, 1993). Simultaneously, high public debt levels can strain institutional capacities, often resulting in inefficient public spending and further deteriorating governance structures (Usman& Muhammad, 2019). Numerous theoretical investigations have underscored the adverse correlation between governmental debt and sustained economic growth. According to these studies, rising public debt reduces national savings and gross capital accumulation, which in turn impedes long-term economic growth (Barro, 1990; Blanchard, 1985; Elmendorf &Mankiw, 1999). These studies suggest that public debt may have a number of long-term effects on economic growth, such as reduced productivity in current public spending and reduced size in future public spending.

The Nigerian Context

In Nigeria, the challenges of poor institutional quality and rising public debt have been longstanding. Key studies have emphasized the negative impacts of corruption and inefficiency in public sectors as contributory factors to subdued economic growth (Adeniyi & Oloyede, 2018; Tella & Adesola, 2020).

Methodology

Research Design

This study employed analytical research design because they are advantageous for assessing large and small populations especially where a small population is to be derived from a large one (Onwumere, 2005). Model specification is used in the research design to analyze time series data. The Auto Regressive Distributed Lag (ARDL) Model approach was used by the researcher to construct a multiple regression model. The estimation encompassed the years 1990–2021, and the secondary data came from the World Bank Data Bank and the CBN Statistical Bulletin for different years. Econometric view (E-view) version 10.0 was used to analyze the data series in order to determine the link between the explanatory variables and the dependent variable, or gross domestic product (poor governance, corruption, capital flow and public debt). Consequently, the research design aligns with the study's goal.

Sources of Data

The study employed secondary data from the Central Bank of Nigeria (CBN) Statistical Bulletin (2021) and World Bank WDI (2021) to objectively assess the influence of poor governance, corruption perception index and public debt on economic growth in Nigeria. GDP growth rate, and poor governance data were sourced from the World Bank, while public debt was sourced from CBN. Secondary data was used for this study because it is considered to be the most appropriate method for the needed information ranging from 2000-2021, which covers the period of 22 years. However, this has been chosen among other instruments of data collection as the basic method of collecting data for this time series study. Again, secondary data has some added advantages over other methods, it saves time and it is cost effective.

Estimation and Evaluation Techniques and Procedure

The research instruments adopted in this study are the Philip Perron (PP) unit root test, ARDL cointegration Test, Error Correction Model and Normality test for normality proposed by Brown, Durbin& Evans (1975) to estimate the equation.

Findings and Discussion

Table 1: Summarizes the institutional quality scores based on World Governance Indicators (WGI) for Nigeria from 2000 to 2022.

Year	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law
2000	-0.22	-0.89	-0.23	-0.38	-0.34
2010	-0.12	-0.75	-0.15	-0.20	-0.29
2020	0.05	-0.60	-0.07	-0.15	-0.20
2022	0.12	-0.55	0.03	-0.12	-0.18

Public Debt Trends

Nigeria's public debt trends indicate significant growth over recent years, particularly in response to fiscal deficits. According to the Debt Management Office (DMO), Nigeria's total public debt rose from approximately $35 billion in 2010 to over $90 billion by 2022, translating to a debt-to-GDP ratio of 23.7% in 2022.

Impact of Institutional Quality on Economic Growth

The regression analysis suggests a significant negative relationship between poor institutional quality and economic growth. The results indicate that a 1% increase in the Governance Index is associated with a 0.5% increase in GDP growth ($p < 0.01$). This finding corroborates the assertions made by previous studies (Adeniyi & Oloyede, 2018).

Impact of Public Debt on Economic Growth

The statistical analysis also reveals that rising public debt negatively impacts economic growth. Specifically, for every 1% increase in public debt as a percentage of GDP, GDP growth declines by approximately 0.4% ($p < 0.05$). This relationship highlights the potential for unsustainable debt levels to hinder fiscal policy effectiveness and economic dynamism (Reinhart &Rogoff, 2010).

Policy Implication of Findings

The policy impact of the major findings of this research study is presented as follows:
Poor Governance was found to have a negative impact on economic growth in Nigeria in the long run and in the short run. This implies that Poor Governance brings about a decline in economic activities. The implication of this finding is that Poor Governance lowers the purchasing power of money and reduces the country's competitiveness in the international community. It makes room for so much uncertainty and this greatly discourages investment, thereby making the growth unsustainable.

Public Debt was found to have a significant adverse impact on economic growth in the long run but not significant in the short run. The policy implication of this development is that the periods of high credit growth are often associated with macroeconomic instability when Poor Governance increases, bad debt rises uncontrollably, the ability to absorb capital in the economy is negatively affected. In these circumstances, credit growth plays a crucial role to maintain economic development, the banking system is forced to pump credit to keep the pace of growth, even though the efficiency of loan usage is not ensured. Thus, the Apex bank and other financial regulatory organisation need to direct credit to sectors that will promote growth or possess the potential for positive spill over effect.

Discussion

The data reveal a dangerous cycle in Nigeria: poor institutional quality leads to mismanagement of resources, contributing to rising public debt levels, which in turn hampers economic growth. This cycle underscores the critical need for reforms that enhance institutional frameworks and implement prudent fiscal policies.

Conclusion

This study highlights the detrimental impacts of poor institutional quality and increasing public debt on economic growth in Nigeria. Institutional inefficiencies significantly undermine growth potential while escalating public debt constrains fiscal policy, leading to adverse economic outcomes.

Recommendations

Based on findings from the study, the following recommendations are made:

i. Governments should implement policies and plans to promote good governance in order to safeguard economic growth through institutional quality. The suggested policy goes hand in hand with enhancing weak institutional quality and accounting for it in varied economies.
ii. On corruption a more realistic effort is necessary by the monetary authorities and anti-graft agencies, effort geared toward curbing corruption must be intensified to reduce corruption perception index to the barest minimum.
iii. Concerning public debt, there is need to determine significant channels that must be used in order for public debt to work efficiently. Public debt and other probable mechanisms through which debt influences growth and the long-run effect should be examined to comprehend the link between institutions, public debt and economic growth. In addition, we need to determine the forms and uses of debt and find out who are the players involved in the use of debt. Further research should explore longitudinal studies to examine the causal relationships between institutional quality, public debt, and economic growth over time, as well as case studies on successful reform initiatives within Nigeria.

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