

## ANALYSIS OF THE COST OF GOVERNANCE AND OPTIONS FOR ITS REDUCTION IN NIGERIA

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### ABSTRACT

*Government at any given level and over a defined territory can be treated as a typical example of a natural monopoly in the sense that only one can exist at any particular time. Thus, the traditional theories of costs and monopoly can be very useful in the analysis of the cost structure of government. Like any other unchecked private monopoly, government and by extension governance, can produce sub-optimal units of public good in which it has comparative advantage. Depending on the resources at its disposal and the tax-elasticity of public goods, massive deadweight costs, among others, often result from a high cost governance structure. This paper explores the effects of destructive political competition. It suggests constitutional provisions that will guarantee true separation of powers, restructure the mechanism of governance to, among other measures, limit the size of the cabinet to reduce the high cost of governance in Nigeria.*

JEL classification: D72, H11, H41

### 1. Introduction

FOR ANY society to prosper, it needs to have a government to run its affairs. The government helps to sustain the social contract that binds every member of the state. Thus, the price that is paid for a state to be prosperous is for it to have an established government that enforces the social contract. Members of an ordered society, called a state, must pay taxes sufficient to carry out the functions assigned to the state. In Nigeria, costs associated with the running of government have increased dramatically over the years such that an increasingly reduced proportion

of public revenue is available to support and implement the primary functions of government (CBN, 2005). Consequently, the discharge of beneficial government functions has been hampered.

A point of departure is to consider how the federal government budget is divided strictly between recurrent and capital expenditures. While recurrent expenditure as a percentage of total government expenditure was 79.22 per cent at the beginning of the 1970s, it had declined to 43.03 per cent by the end of the 1970s (see table 1). It rose to 49.30 per cent by the end of the Second Republic in 1983, further rising to 63.36 per cent by the end of the 1980s. The dramatic rise in export earnings due to the oil boom of the 1970s resulted in a reduction in the proportion of the budget allocated to recurrent expenditure. Correspondingly, the drastic fall in the price of crude oil in the early 1980s equally raised the proportion of the budget apportioned to recurrent expenditure. Though there was a decline in the proportion of the budget allotted to recurrent expenditure, from 60.10 per cent in 1990 to 36.56 per cent in 1990, it has since risen to 80.29 per cent in 2003. The justification for using recurrent expenditure as a percentage of the total budget as an important indicator of the cost of governance stems from the belief that capital expenditure impacts more positively on the economy in respect of employment, investment and other growth-inducing activities.

Where a rising proportion of government budget, at whatever level, is used to support the administrative structure of government, poverty is bound to be pervasive as economic growth slows down or even stagnates. In 1977, total administrative expenditure as a percentage of total government expenditure was as high as 32.04 per cent, rising further to 38 per cent in 1983 (see table 2). What this implies is that maintaining government administrative structures comes at gargantuan costs to the economy, as available funds are barely sufficient to finance projects in vital sectors of the economy. Enormous administrative expenditure is not only used to finance an unusually large, inefficient and corrupt civil service personnel, but also a larger than optimal executive cabinet, and an ineffective legislature.

Total administrative expenditure as a percentage of gross domestic product (GDP) was as high as 8.72 per cent in 1977 but fell to an all time low of 2.04 per cent in 2002 (see table 3). If we assume that government administrative expenditure supports the GDP of any given society, then an administrative expenditure of nearly 9 kobo went into the production of ₦1 (one naira) worth of goods and services for the period 1977 to 2002. Over the subsequent years, the administrative costs of producing ₦1 worth of goods and services fell to 2 kobo in 1989. It rose to 4 kobo in 1999 and then to 7 kobo in 2002. If we assume that the government is a firm with output measured in GDP, then it would not be difficult to see why the cost of production (measured here as cost of governance) seems to have risen over time. While a private firm can almost always pass on the

**Table 1. Analysis of Federal Government Expenditure (1970-2005)**

| Year | Rec. Exp (N'm) | Cap. Exp (N'm) | Tot. Exp (N'm) | Rec % Tot | Cap% Tot |
|------|----------------|----------------|----------------|-----------|----------|
| 1970 | 716.10         | 187.80         | 903.90         | 79.22     | 20.78    |
| 1971 | 823.60         | 173.60         | 997.20         | 82.59     | 17.41    |
| 1972 | 1012.30        | 451.30         | 1463.60        | 69.17     | 30.83    |
| 1973 | 963.50         | 565.70         | 1529.20        | 63.01     | 36.99    |
| 1974 | 1517.10        | 1223.50        | 2740.60        | 55.36     | 44.64    |
| 1975 | 2734.90        | 3207.70        | 5942.60        | 46.02     | 53.98    |
| 1976 | 3815.40        | 4041.30        | 7856.70        | 48.56     | 51.44    |
| 1977 | 3819.20        | 5004.60        | 8823.80        | 43.28     | 56.72    |
| 1978 | 2800.00        | 5200.00        | 8000.00        | 35.00     | 65.00    |
| 1979 | 3187.20        | 4219.50        | 7406.70        | 43.03     | 56.97    |
| 1980 | 4805.20        | 10163.30       | 14968.50       | 32.10     | 67.90    |
| 1981 | 4846.70        | 6567.00        | 11413.70       | 42.46     | 57.54    |
| 1982 | 5506.00        | 6417.20        | 11923.20       | 46.18     | 53.82    |
| 1983 | 4750.80        | 4885.70        | 9636.50        | 49.30     | 50.70    |
| 1984 | 5827.50        | 4100.10        | 9927.60        | 58.70     | 41.30    |
| 1985 | 7576.40        | 5464.70        | 13041.10       | 58.10     | 41.90    |
| 1986 | 7696.20        | 8526.80        | 16223.00       | 47.44     | 52.56    |
| 1987 | 15646.20       | 6375.20        | 22021.40       | 71.05     | 28.95    |
| 1988 | 19409.40       | 8340.10        | 27749.50       | 69.95     | 30.05    |
| 1989 | 25994.20       | 15034.10       | 41028.30       | 63.36     | 36.64    |
| 1990 | 36219.60       | 24048.60       | 60268.20       | 60.10     | 39.90    |
| 1991 | 38243.50       | 28340.90       | 66584.40       | 57.44     | 42.56    |
| 1992 | 53034.10       | 39763.30       | 92797.40       | 57.15     | 42.85    |
| 1993 | 136727.10      | 54501.80       | 191228.90      | 71.50     | 28.50    |
| 1994 | 89974.90       | 70918.30       | 160893.20      | 55.92     | 44.08    |
| 1995 | 127629.80      | 121138.30      | 248768.10      | 51.30     | 48.70    |
| 1996 | 124491.30      | 212138.30      | 336629.60      | 36.98     | 63.02    |
| 1997 | 158563.50      | 269651.70      | 428215.20      | 37.03     | 62.97    |
| 1998 | 178097.80      | 309015.60      | 487113.40      | 36.56     | 63.44    |
| 1999 | 449662.40      | 498027.60      | 947690.00      | 47.45     | 52.55    |
| 2000 | 416608.50      | 239450.90      | 656059.40      | 63.50     | 36.50    |
| 2001 | 579329.10      | 438696.50      | 1018025.60     | 56.91     | 43.09    |
| 2002 | 696777.70      | 321378.10      | 1018155.80     | 68.44     | 31.56    |
| 2003 | 984277.60      | 241688.30      | 1225965.90     | 80.29     | 19.71    |
| 2004 | 1032741.30     | 351259.90      | 1384001.20     | 74.62     | 25.38    |
| 2005 | 1223730.00     | 519510.00      | 1743240.00     | 70.20     | 29.80    |

Source: CBN Statistical Bulletin, 2005; the various percentages were computed by the authors.

Notes:

|   |  |
|---|--|
| Tot - Total expenditure   | Rec. Adm. Exp- Administrative Expenses (Recurrent)                 |
| Rec - Recurrent expenditure   | Cap - Capital Expenditure  |
| Rec % Tot- Recurrent Expenditure as percentage of total expenditure | Cap % Tot - Capital expenditure as percentage of total expenditure |

**Table 2. Analysis of Federal Government Expenditure (1977-2005)**

| Year | (A)           | (B)           | (A + B)       | Tot. Gov. Exp. | Tot. Adm. %    |
|------|---------------|---------------|---------------|----------------|----------------|
|      | Rec. Adm. Exp | Cap. Adm. Exp | Tot. Adm. Exp |                | Tot. Gov. Exp. |
| 1977 | 1331.2        | 1524.5        | 2855.7        | 8823.8         | 32.36          |
| 1978 | 1081.3        | 1112.5        | 2193.8        | 8000.0         | 27.42          |
| 1979 | 1165.8        | 1109.1        | 2274.9        | 7406.7         | 30.71          |
| 1980 | 1709.0        | 1501.1        | 3210.1        | 14968.5        | 21.45          |
| 1981 | 2174.5        | 682.3         | 2856.8        | 11413.7        | 25.03          |
| 1982 | 2174.1        | 930.6         | 3104.7        | 11923.2        | 26.04          |
| 1983 | 2567.9        | 1098.0        | 3665.9        | 9636.5         | 38.04          |
| 1984 | 1659.9        | 573.4         | 2233.3        | 9927.6         | 22.50          |
| 1985 | 1927.0        | 502.0         | 2429.0        | 13041.1        | 18.63          |
| 1986 | 2008.4        | 574.1         | 2582.5        | 16223.0        | 15.92          |
| 1987 | 2214.3        | 274.5         | 2488.8        | 22021.4        | 11.30          |
| 1988 | 3856.0        | 1306.5        | 5162.5        | 27749.5        | 18.60          |
| 1989 | 3592.0        | 993.9         | 4585.9        | 41028.3        | 11.18          |
| 1990 | 5404.5        | 1969.7        | 7374.2        | 60268.2        | 12.24          |
| 1991 | 7413.7        | 2942.9        | 10356.6       | 66584.4        | 15.55          |
| 1992 | 8842.6        | 3404.6        | 12247.2       | 92797.4        | 13.20          |
| 1993 | 18769.1       | 6788.0        | 25557.1       | 191228.9       | 13.36          |
| 1994 | 20851.7       | 10832.7       | 31684.4       | 160893.2       | 19.69          |
| 1995 | 32824.5       | 1685.5        | 34510.0       | 248768.1       | 13.87          |
| 1996 | 49128.0       | 13328.4       | 62456.4       | 336629.6       | 18.55          |
| 1997 | 45905.1       | 31462.8       | 77367.9       | 428215.2       | 18.07          |
| 1998 | 51942.0       | 49808.7       | 101750.7      | 487113.4       | 20.89          |
| 1999 | 97048.0       | 42730.0       | 139778.0      | 947690.0       | 14.75          |
| 2000 | 110287.9      | 46026.1       | 156314.0      | 701059.4       | 22.30          |
| 2001 | 180810.0      | 4925490.0     | 5106300.0     | 1018025.6      | 501.59         |
| 2002 | 331736.0      | 73577.4       | 405313.4      | 1018155.8      | 39.81          |
| 2003 | 307848.5      | 87958.9       | 395807.4      | 1225965.9      | 32.29          |
| 2004 | 306842.8      | 137775.8      | 444618.6      | 1384001.2      | 32.13          |
| 2005 | 434671.8      | 171614.1      | 606285.9      | 1743240.0      | 34.78          |

Source: Same as table 1.

Notes:

Rec. Adm. Exp - Administrative expenses (Recurrent)

Cap - Capital Expenditure

Cap % Tot - Capital Expenditure as percentage of total expenditure

Cap. Adm. Exp - Administrative Expenses (Capital)

Tot. Adm. Exp - Total Administrative Expenses

Tot Gov Exp - Total Government Expenditure

Tot Adm % Tot Gov. Exp- Administrative Expenditure as percentage of Total Government Expenditure

**Table 3. GDP Administrative Expenditure and Government Expenditure (1977-2004)**

| Year | Gov. Con. Exp. | GDP (Current Prices) | Tot. Adm. % GDP | Tot. Gov. Exp.%GDP |
|------|----------------|----------------------|-----------------|--------------------|
| 1977 | 3826.9         | 32747.3              | 8.72            | 26.95              |
| 1978 | 4996.5         | 36083.6              | 6.08            | 22.17              |
| 1979 | 4887.7         | 43150.8              | 5.27            | 17.16              |
| 1980 | 5051           | 50848.6              | 6.31            | 29.44              |
| 1981 | 6619           | 50749.1              | 5.63            | 22.49              |
| 1982 | 6816           | 51709.2              | 6               | 23.06              |
| 1983 | 7489           | 57142.1              | 6.42            | 16.86              |
| 1984 | 6925           | 63608.1              | 3.51            | 15.61              |
| 1985 | 7342           | 72355.4              | 3.36            | 18.02              |
| 1986 | 7488           | 73061.9              | 3.53            | 22.2               |
| 1987 | 7395           | 108885.1             | 2.29            | 20.22              |
| 1988 | 9253.3         | 145243.3             | 3.55            | 19.11              |
| 1989 | 10076.2        | 224796.9             | 2.04            | 18.25              |
| 1990 | 11468.7        | 260636.7             | 2.83            | 23.12              |
| 1991 | 12689          | 324010               | 3.2             | 20.55              |
| 1992 | 20431.8        | 549808.8             | 2.23            | 16.88              |
| 1993 | 27583          | 697090               | 3.67            | 27.43              |
| 1994 | 88510          | 914940               | 3.46            | 17.59              |
| 1995 | 123150         | 1977740              | 1.74            | 12.58              |
| 1996 | 143090         | 2823900              | 2.21            | 11.92              |
| 1997 | 171270         | 2939650              | 2.63            | 14.57              |
| 1998 | 204340         | 2881310              | 3.53            | 16.91              |
| 1999 | 252550         | 3352650              | 4.17            | 28.27              |
| 2000 | 260336         | 4980943              | 3.14            | 14.07              |
| 2001 | 275462         | 5639865              | 90.54           | 18.05              |
| 2002 | 277370         | 5901970              | 6.87            | 17.25              |
| 2003 | 285870         | 6947819.9            | 5.7             | 17.65              |
| 2004 | 281340         | 3201996.4            | 13.89           | 43.22              |

*Source:* Same as table 1.

*Notes:*

- Gov. Con. Exp- Government Consumption Expenditure at Current Prices
- GDP (Current Prices) - Gross Domestic Product at Current Market prices
- Tot. Adm % GDP- Total Administrative Expenditure as of percentage of GDP.
- Tot. Gov. Exp%GDP- Total Government Expenditure as of percentage of GDP.

high costs of production to the consumers in the form of high product price, or would be forced out of business, high governance costs tend to cripple markets, stunt economic growth, leads to rapidly rising inflation, crowd-out private investment and distort the real relationship between productivity and rewards (Cebula, Carlos and Koch, 1981).

When political institutions have considerable discretionary powers in the allocation or redistribution of resources relative to market institutions, unduly considerable efforts are expended on capturing political power. The dissipation of financial, physical and intellectual energies in capturing governance of the state leaves very little for creating appropriate conditions for cultivating a developmental state. Much of the high costs of governance are largely due to the absence of institutional structures that direct attention away from predation to production. When the primary function of a state is essentially redistributive or predatory, productive activities become less significant as a driving force of economic activities. Redistributive politics at their very best raise the cost of governance in a way the figures quoted earlier cannot fully capture, and very little is spent creating the wealth that would be of benefit to all. While high recurrent expenditure/total government expenditure and recurrent expenditure/total GDP ratios have negative effects on economic growth, the high cost of governance exerts considerable destructive effects on the polity and economy by inhibiting efforts directed at the development of the society.

According to Ibi-Ajayi (2002), there are two types of government failure. The first entails government's involvement in activities in which she is not best suited. For instance, inappropriate government intervention would raise entry barriers into a particular industry, creating monopoly rents and allowing officials of government to take bribes (Emerson, 2005; IMF, 2005). The second is the failure of government to perform its primary functions or to do so in a sub-optimal way. For example, the inadequate provision of public goods or security or law and order, is a typical failure of government in Nigeria. Both types of failure have adverse effects on growth and development, though our model will capture only the second type of government failure and its impact on the polity.

Our analysis shows that the high cost of governance cannot be fully captured by using quantitative parameters such as recurrent/total expenditure ratio, recurrent/GDP ratio, administrative expenditure/total expenditure and the like by themselves. More than anything else, greater harm has been done through a disproportionately large political industry given the ability to exercise considerable discretionary powers in the allocation of state resources put at its disposal. This forms the motivation for the present study with the objective of analysing the continuous rising costs of governance in Nigeria and suggests possible ways of reducing them. The next section tries to capture Olsen's theory of the state as well as the Bates, Greif and Singh (2002) thesis of using state monopoly of violence for

development or predatory purposes. Section 3 represents our model, which seeks to show how fractured political institutions implanted by colonial masters in combination with the opportunistic use of ethnicity by rent-seeking political elites created an inefficient, and costly, governance structure. Section 4 discusses a few options that might help to reverse the trend while section 5 presents the conclusion.

## **2. Economic Theory of the State**

The structure of government inherited at independence is largely a reflection of colonial influence. The colonial powers arbitrarily divided the African continent so that ethnically unrelated peoples were forced into political matrimony for the formation of a state (Easterly and Levine, 1997). Colonial governments established 'extractive institutions' in places where unfavourable weather had serious health consequences for them and created European-style institutions in places favourable for habitation (Acemoglu et al., 2001). Thus, weak institutions, amply represented by growth-inhibiting political structures, became the dominant feature of resource-rich multi-ethnic societies. The opportunistic behaviour of ethnic leaders, particularly in a mineral-rich polity such as Nigeria, eventually produced a government structure that had a negative toll on social and economic progress. Our model in section 3 gives more details.

Two important studies (Subramanian and Sala-i-Martin, 2003; Artadi and Sala-i-Martin, 2003) illustrate the deleterious impact of governance on Nigerian economic growth and development. In the study by Artadi and Sala-i-Martin, sub-Saharan African (SSA) countries performed abysmally on all the indices considered. Factors such as superficial economic reforms, weak institutions, excessive public spending, and many others, worked through various channels to reduce economic growth and adversely affect the well-being of the people. If we admit that the identified growth-inhibiting factors have been manipulated by government to fast track the growth process, then we can conclude that the enormous resources at the disposal of the Nigerian government for the people were not meaningfully utilized to bring about desired economic development. In addition to the factors mentioned above, high tariffs, the use of export and import licences, indiscriminate use of import bans, government involvement in the production of private goods and the economically harmful intervention strategies of government represent the high price the society had to pay for 'mis-governance' by the political elite (Iyoha and Oriakhi, 2002).

In the other study (Subramanian and Sala-i-Martin, 2003), per capita GDP (in Purchasing Power Parity-PPP terms) which was US\$1113 in 1970 had declined to US\$1084 thirty (30) years later. Within the same period, the poverty rate, measured by the fraction of the population living on less than US\$1 per day, had increased from 36 per cent to 70 per cent. The absolute number of the poor rose from 19 million in 1970 to 90 million in 2000. In the same study, the income

distribution data showed that the top 2 per cent and bottom 17 per cent of the population earned the same amount of income in 1970. By the year 2000, the top 2 per cent and the bottom 55 per cent were earning the same total income. Within the 30-year period, the vibrant and productive middle class had been decimated and many were pushed into the low-income category by governance institutions that made rent-seeking a lucrative pastime of the privileged political class. Though Nigeria earned US\$350 billion between 1965 and 2000, and oil revenues per capita rose from US\$33 to US\$325, GDP per capita stagnated within the same time span. Whatever was earned during the period did not add any value to lives or increase living standards. Rather, it created a governance structure which caused living standards to decline. Consequently, a larger than optimal civil service, dominated mainly by that section of the country with significant human capital deficiencies was bound to raise governance costs and institutionalize the mechanisms for rent extraction.

Let us try to identify at least one public good with a high degree of public interest, upon which there is a broad consensus that it could be more cheaply provided by government. Such a public good is law and order (security for short). This can be more cheaply provided by a central government. If we admit that in reality there is no pure public good, we should understand why profit-maximizing firms could equally provide complementary security services. However, government provides the bulk of security services. Thus, the role of the private sector in the security sector is minimal. We recognize that the different levels of government would be able to organize security effectively. The absence of the centralization of security affects its efficiency and drives up the cost of making security available.

This model will draw mainly from the insight provided by Olsen (1965) and Bates et al. (2002). In conventional economic theory, the state is a product of co-operation. In other words, rational humans who live within a defined territory discover a net gain in co-operation rather than in competition. It could be likened to a group of many perfectly competitive firms who form a collusive unit called a monopoly.

In figure 1, we see that all firms that operate in a competitive market will produce  $Q_c$  and charge price,  $P_c$ . All firms in such markets earn only normal profit in the long run. Any firm that undercuts other rivals will be forced out of the market because it is unlikely that all costs would be covered in the long run. The alternative is to raise the price to  $P_m$  and restrict output to  $Q_m$ . Should any firm do that unilaterally, it would lose a considerable number of customers to rivals in the industry. In a perfectly competitive market, it would lose all of its customers. The greater the degree of competition in the industry, the higher the loss of patronage due to unilateral price increases.



The best option is for all firms to cooperate and act as a single body — the monopolist. By cooperating, they can collectively raise price to  $P_m$  and reduce output to  $Q_m$  from  $Q_c$ . The gain from cooperation is represented by rectangle  $ABP_cP_m$ . This represents a profit level above what is obtainable in a perfectly competitive long run situation. The good thing about cooperation is that no automatic mechanism exists to erode the supernormal profit earned by cooperating firms. Thus, such huge profits can be enjoyed for externality. To simplify our analysis let us assume that the industry in question is a constant cost industry, where increase in output will not lead to a rise in costs. Hence, our marginal cost  $MC$  can be drawn as a straight line across a range of output.

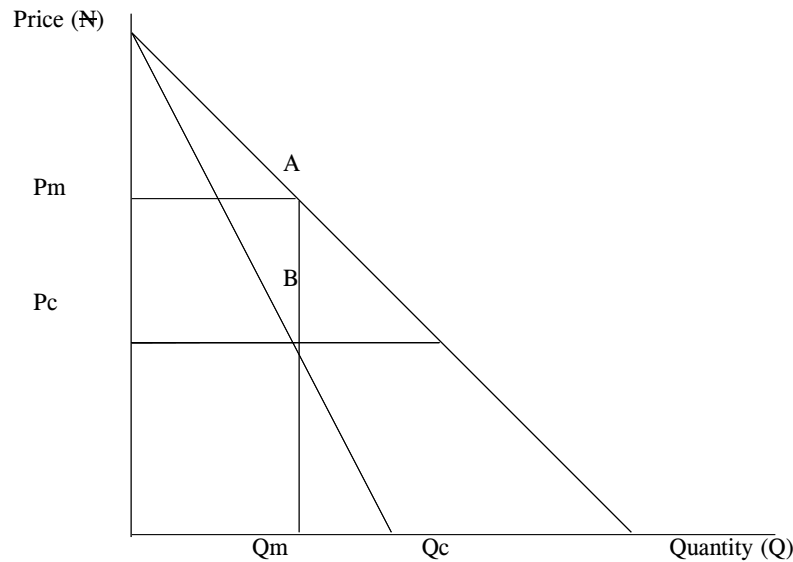


Fig.1: Competition Vs Cooperation

Figure 1. Competition versus Cooperation

While cooperation will yield positive profit, there is the challenge of sharing the surplus profit  $ABP_cP_m$  among several firms in the industry. The larger the number of firms in the industry, the greater the difficulty of sharing the profit. One method of getting around this problem is to allocate a fixed quota to each firm and  $P_m$  will remain the market price. However, with higher price  $P_m$ , there remains an incentive for each to violate the quota share and produce more. Members of the Organisation of Petroleum Exporting Countries (OPEC) have often done this. As long as there are few violators, the monopoly  $P_m$  may not be significantly affected. As quota violation grows, the actual price deviates more

from the monopoly price,  $P_m$ . The possibility of such violations raises the need to police all firms in the industry to detect and punish violators appropriately. Policing can be costly, and unless the cost is lower than the supernormal profits to be earned, no successful cartel can be formed. The firms need to create a police unit to monitor and enforce compliance with collective agreements. The state should therefore be the common agency required to police all firms and ensure compliance with agreement.

From a political economy perspective, the state is the by-product of rational individuals who believe that state formation would be better than living as individuals or families. The state, therefore, as well as being the government's instrument of operation, is a natural monopoly; for no two organizations with equal powers of force over a defined territory can co-exist successfully and maintain relative peace. The slip into anarchy in Somali is a very recent example of two powerful organizations claiming rulership of one country.

Two important observations need to be made at this point.

- a. The cost-effectiveness of providing security through a central unit, the government, has not been proven.
- b. It is not true in the general sense that all stateless societies will slip into anarchy.

Long before now, anthropologists have proved that individuals organized in kinship groups in stateless societies can indeed co-exist peacefully (Bates et al., 2002). This is a strong argument against the Hobbesian descent into anarchy in the absence of state and government. However, though there was peace in these societies, there was no development: and so the huge trade-off for peace is development. From here, we develop our argument that the recognition of a need for a state by those in a stateless society helps to accelerate development. As long as the state is used to serve the interests of the larger society the cost of governance falls.

The key features of these stateless societies reveal why there was no development, and why it is unlikely that there will be any. In these societies, security is privately provided; every member of these societies is either a soldier or one in the making. Kinship units perform the functions of government in terms of defence of property rights and persons (Bates, 2002). Reputation for aggressiveness, religious fundamentalism and unsettled past feuds remain real sources of threat to life and property. The need to keep the peace by everyone becomes a preferred option because of the use of tit-for-tat strategy in kinship groups in such societies. In these self-governing kinship societies, options exist for ensuring peace and development.

The model of Bates et al. (2002) helps to explore these options and how the transition to statehood can help to reduce the cost of governance. According to

their model, individuals maximize their utility by consuming both goods (bought with income) and leisure. In addition, their time is divided between procuring income and leisure as well as in military training. Income can be increased by producing goods and by raiding others who have done the same. In societies where repeated interaction is possible, the use of tit-for-tat strategy has a vital role to play in keeping the peace. Let us now examine the two options available and the costs attached to each of them.

Kinship groups are faced with the dilemma of production. The society as a whole is worse off if every member diverts resources from production to predation. Though there is the possibility of anarchy, importantly, there is also the possibility for peace because anticipated outcomes will leave everyone bloodied, an outcome that is evidently least preferred. Resources can equally be channelled from predation to the production of goods and leisure activities.

Let us assume the latter option as the first best strategy. This option will only lead to prosperity if people can resist the temptation to steal. If this is possible, individuals will not only channel more time to production instead of predation, but will also allocate more time to work and less to leisure. This would be a 'utopian society of saints'. In a society populated by the good, the bad and the ugly, the more likely outcome will be the allocation of more time to leisure and little time to work. Little work will produce little output and the incentive to steal would be thereby minimized. Thus, where no military effort is expended, peace is ensured at the expense of ample productivity. Pronounced poverty is a key feature of this kind of society. It is characterized by zero public good and little private good. Expectedly, the cost of self-governance in this type of society would be very high in terms of the lack of development. Still following the argument of Bates et al., the other option would involve the allocation of time between the production of income and military activities. The condition for prosperity is that all must be armed. Military training and preparation is therefore the price that it pays for prosperity. For limited prosperity to exist there must be a balance of military power across several kinship groups. In the case of the first option there is zero security as a public good and in the second, there is too much of the public good, security.

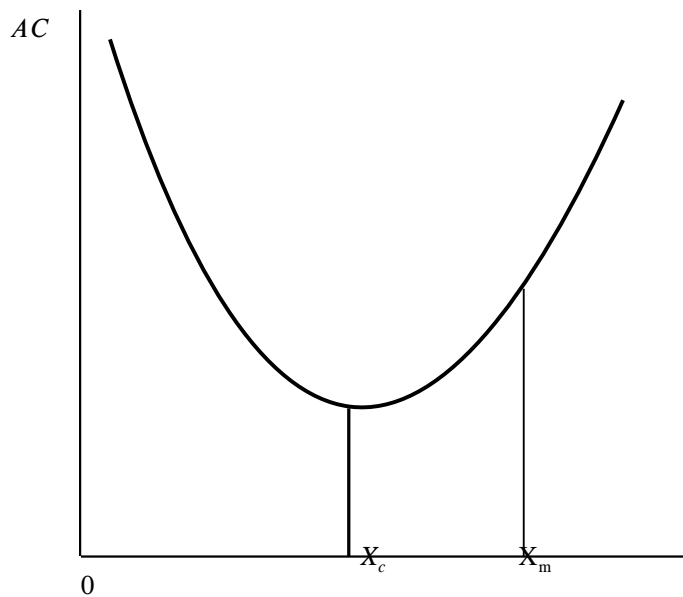
### **3. Theoretical Model**

#### **3.1 Introduction**

From our discussion in the last section, the cost of governance is expected to be high in both societies: one with zero public goods and the other with much public goods. For in the first, peace is assured on account of little prosperity and in the second, limited prosperity can only be guaranteed at the expense of over-investment in security. The two situations are characterized by the private provision of security. In between the two extremes described, are other

intermediate possibilities. Pockets of kinship groups can come together to form a standing army of strong, trained men whilst other members of the groups would devote much of their time to the production of income, part of which would be paid to members of the standing army as professional fees.

This arrangement exploits the opportunities offered by comparative advantage of members in the production of income and military activities. As more kinship groups see the need for one strong standing army and join in forming one, the unit cost of providing security as a public good falls. Consenting kinship groups will tend towards this arrangement as long as fair and just rules for regulating the standing army exist, and a state and government can be established to oversee the activities of this standing army. The optimal size of an army, depicted by  $X_m$  in figure 2 is only possible when a state is formed and a government established to run it.



**Figure 2. Average Cost (AC) of Supplying of Public Good – Security**

Optimal security would be what could be provided through a central government without raising the average cost of security. The optimal arrangement that would secure this is to allow the central government to take charge of security against external aggressors and be responsible for a large part of internal security. This arrangement does not preclude the use of other regional units that might be efficient producers of local security services. For optimal security to be publicly provided when a state is formed private provision of security must be largely

disallowed. When a state is constituted properly it is possible for that society to end up with an optimal mix of private good, and publicly provided good, which in our example is security. In an economy that consumes two types of goods – private and public, for economic efficiency, private goods can be more cheaply provided by private firms and public goods by a collective organization – the government. At equilibrium, no reallocation of roles between the private and public sectors will be able to raise output. In other words, for the available human and non-human resources in society, output can no longer be increased since each sector produces goods in which it has comparative advantage. Thus, the last naira spent on private goods will raise output by as much as the last naira spent on public goods.

This foregoing analysis is important because the cost of governance is minimal when each (private and public sectors) is only allowed to do what it can do best. Providentially, the free market imposes adequate discipline on the players in a way that drives them to produce at minimal cost. Where adequate and well-defined constitutional and legal rules are lacking, players, particularly the politicians, are not constrained to seek to minimize the cost of governance. To appreciate our argument, we assume that the last naira spent on public goods raises output by less than what the same amount spent on private goods would. It is important that we reallocate resources to the private sector and away from the public sector if we intend to raise output for the society. However, in the absence of rules of political conduct or when these are ill defined, there is neither an inherent tendency for this to take place nor does there exist an automatic mechanism to ensure this optimal outcome.

### **3.2 Partial colonial masters**

To the extent that consenting ethnic groups did not form the Nigerian state, adequate ground rules for the operation of the state were not spelt out. The personal or discretionary rule that followed created a lopsided structure that raised the cost of governance. This line of argument will be elaborated upon later. If the over 250 ethnic groups had jointly decided to form a federation called Nigeria, we could have ended up with an arrangement that would provide public goods somewhere near the optimal,  $X_M$  (in fig. 2). Equally, an impartial third party could also have helped the process of building a viable federation. Nigeria, however, was decreed into existence by a predatory colonial power, earnestly looking for resources outside its own borders for continued growth and development. Though administrative efficiency and governance cost considerations informed the basis for amalgamating the Northern and Southern parts of Nigeria, complementary democratic and market institutions to harness the economies of scale afforded by a larger population and bigger territory were never put in place. Since Britain adopted the divide-and-rule strategy, what she left were people fractured along ethnic lines. In place of democratic and market-oriented institutions that could

accelerate economic growth and development, what we had was a highly imperfect political arrangement that impeded the free market as an important institution for resource allocation. Market-driven institutions could have translated political independence to economic prosperity and reduced dependence on colonial powers. For colonial domination to continue after independence, it was important for Britain to encourage, influence and support any arrangement that put political considerations ahead of economic growth and development. Britain found an ally in that part of Nigeria that was least likely to benefit from a free market given its low level of investment in human capital.

### **3.3 Education and information asymmetry**

Information asymmetry between politicians and voters is likely to be more pronounced in areas with low human capital investment than those with a higher level of human capital investment. It is not surprising that a pan-Nigerian party, like the National Congress for Nigeria and Cameroon (NCNC), which won in the West, could not gain a foothold in the North during the 1955 elections. If limited education implies limited information for making appropriate voting preferences during elections, people would attempt to solve the problem by voting for those they know, i.e., politicians who are of the same ethnic stock. It is this method of dealing with information asymmetry problems that leaves us with a political industry populated by political lemons (Akerlof, 1970). Areas with a higher information asymmetry problem will naturally produce a higher number of political lemons, a bunch of unproductive rent-seeking politicians and bureaucrats dressed in the garb of ethnic champions.

The growing cult of political lemons continuously diminishes the incentive for productive and contributory participation in the public service. The analogy by Achebe (1983) helps to highlight the cost implications of sacrificing merit on the altar of ethnicity. According to him:

Let us take a hypothetical case where two candidates A and B apply to fill a very important and strategic position. A has the right qualification of competence and character but is of the wrong tribe, while B, less qualified, belongs to the right tribe, and so gets the job. A goes away embittered. B throws a party and messes up the job. The greatest loser is the nation itself, which has to contain the legitimate grievance of a wronged citizen, accommodate the incompetence of a favoured citizen and more importantly endure the general decline in morale and subversion of efficiency caused by an erratic system of performance and reward.

### **3.4 The rising cost of governance**

The supply of security beyond  $X_M$  (in fig. 2) could arise in both state and stateless societies. In a stateless society, it could be due to the devotion of leisure time to military training and preparation. Security is oversupplied and that leads to limited prosperity. In a society with a state, it could happen when political lemons take advantage of ethnicity and the lack of education or information to grab political power or could be due to the seizure of the collective organization of the state by a particular ethnic group (made up of political lemons) so that the standing army formed excludes other ethnic groups or only involves them to a limited extent. When a state is characterized by an unequal distribution of resources, groups less resource endowed might form a coalition to seize the standing army. When members of a standing army with comparative advantage in violence start active participation in civil governance in which they suffer a comparative disadvantage, the cost of governance will systematically rise. More important is the fact that excluded groups, which have disarmed, will rearm. This would be done to ensure the survival of the groups and to stop the predatory activities of the state. The cost consequences are enormous and represent a diversion of resources from developmental activities to the financing of unproductive projects.

Within the context of the Nigerian experience, the optimal units of security would be  $X_M$ . At  $X_M$ , the highest output of private goods is attainable because specialization allows the exploitation of comparative advantage in the production of public and private goods. This kind of arrangement leaves us with one big worry, the pattern of income distribution. This is a serious problem because the arrangement that guarantees an optimal cost structure of governance will not coincide with the one that gives every ethnic group within the polity a fair representation. A way of illustrating this is to imagine the kind of Super Eagles we would have should we insist that each State of the Federation must be given fair representation. A cost of governance was the price we had to pay for undue consideration for equity. However, as we would show in the later part of this section, we had neither equity nor efficiency, as appointments into public service were in favour of groups with the least investment in human capital.

In the last section, we have shown that a central unit (third party) is required for policing to be done. Importantly, we have shown that it is cheaper to provide security publicly than to allow it through private means. Note that security is not the only public good that a state and its government can publicly provide, but we picked security because it is at least one thing that the free market exponents (except of course the anarchists) will agree should be publicly provided. There is therefore a range of goods and services that can be provided through the state. The individual incentives to provide certain goods diminishes as the public provision of the goods increases. Thus, the analysis in this section also applies to any public good.

### **3.5 Ethnicity and the cost of governance**

Natural and human resources may skew income distribution in favour of endowed groups when the market is allowed to be the principal mechanism for resource allocation. Free markets are therefore more likely to be hindered when pronounced disparities exist in the distribution of natural and human capital endowments among groups that exist in a particular society. This mostly explains why the nationalists of northern extraction did not agree at first with the idea of an independent Nigeria since their limited investment in human capital would put them at a disadvantage in a post-independent Nigeria. The political arrangement that eventually persuaded Northern Nigeria to agree to be part of independent Nigeria did not coincide with an arrangement that would provide an optimal composition of government and minimal cost of governance. Worse still the arrangement allowed costly intervention strategies in the operation of the free market. Partly due to reigning Keynesian orthodoxy in the 60s and partly due to ignorance, zones that stand to benefit more from the operation of free markets never really pushed for a constitutional arrangement to guarantee this. Nationalism of the era ensured that the commanding heights of the economy were left in the domain of the public sector. With the benefit of hindsight, one could say this arrangement signalled the beginning of patronage activities that stifled the market and productivity, promoted rent seeking, brought an imbalance between efforts and rewards, and raised the cost of governance. It puts the public sector at the hub of economic activities in Nigeria.

To understand how the ethnic factor entered into the cost structure of governance, we will build up on Kimenyi's 1998 (cited in Kimenyi, 2001) argument and add a few assumptions. According to him, different ethnic groups could be regarded as firms organized for production. Within each ethnic enclave, and given their resource endowments, each group can generate both consumer and producer surpluses. Self-governing ethnic groups can engage in trade to enhance their surpluses. The use of a market helps to enhance efficiency by penalizing inefficient ethnic groups with small surpluses. However, given a highly imperfect political market, each ethnic group can equally raise its surpluses by using political institutions to transfer wealth from richer groups to itself. It is important that the political market be imperfect in the sense that the outcome of political decision does not coincide with the true preferences of members of that society.

Let us assume that a given society is broadly divided into groups A and B. If A is more endowed and B is less, then B would favour the use of political institutions as the main mechanisms for the distribution of wealth and A would naturally favour the free market. If those who represent A will not benefit from a market-based economy, the outcome of negotiation will make politics the main instrument of access to wealth. This arrangement will stunt the market, underdevelop entrepreneurship and divert resources toward capturing political power. Group A could also agree to this kind of lopsided arrangement if its initial



advantage in human capital investment could allow it a respectable place in government bureaucracies or if at the time of bargaining there were no substantial differences in natural resource endowments between them. However, group B could have one strategic advantage; it might have invested a lot in acquiring military prowess given the enormous powers such an important unit of government would possess. Thus, while A may have more natural and human resource endowments than B it has less military capabilities. If A has direct control of state, it could use its monopolistic power of coercion to appropriate resources of the more endowed group A and redistribute it among its own members. The injustice that this involves makes private provision of security inevitable. It is not by coincidence that the greatest number of militant groups are found in the Niger Delta. The appropriation of oil resources of this zone and the attendant environmental disasters that followed would guarantee no other outcome than what is presently observed. To keep the status quo that permitted rent extraction from the state, more resources had to be devoted to military activities in a way that made the cost of governance rise dramatically.

Rent extraction and over-supply of security limit the prospects of building a developmental state. The limited prosperity achieved under this arrangement does not follow the usual pattern of matching productivity and reward but skewed privileges in favour of those who wield political power and influence, irrespective of the ethnic group to which they belong. To ensure continuous rent-extraction, members of the winning coalition A will most likely invite elites from group B to share in the spoils of rent-seeking activities. Thus, the need to preserve the initial capture of state apparatus of power will result in the formation of a bloated cabinet of state predators. Either through capital or recurrent expenditure, rent-extraction becomes a characteristic feature of the state-predator relationship. The society pays for it in the high cost of governance.

By way of summary, we could say that initial differences in resource endowments generate predatory instincts in the less-endowed group. To maintain its control, it has to run a cabinet and bureaucracy with a disproportionately large number of its own group and some of the least competent members of the more endowed groups (Kimenyi, 2001; Subramanian and Sala-i-Martin, 2003). Since competence is the least quality required in public service, the regime of inefficiency is foisted on the whole society. Incompetent government and its inefficient bureaucracies will not only hinder political competition, but must also inhibit the market to guarantee continuous hold on power (Acemoglu and Robinson, 2004).

Where political institutions are allowed the luxury of unconstrained and considerable power in the allocation of national output, competition for political power may be intense. The regime of a one party system and personal rule, which characterized many post-independent African countries, is a direct fallout of institutional weaknesses that fail to put a cap on the expenditure profile of

government and have made it the main centre of resource allocation. Politics therefore became so lucrative that the temptation to close the political space could not be resisted. Given the inhibitions in the political industry that make regime change practically impossible through democratic means, the violent takeover of government became the main mechanism for effecting regime change. According to Kimenyi (2001), between 1960 and 1982, nearly 80 per cent of the 45 independent countries in SSA had experienced coups. In Jakande's (1983) classic piece, he stated that the attainment of national sovereignty is mixed with a spate of political trials for treason and allied offences. The relapse into military dictatorship that faced little or no social or legal constraints, further weakened the institutions that should have ensured optimal use of society's resources. The costs to society have been enormous. We thus have neither a competitive economy nor true democracy.

The absence of both slowed growth and healthy political competition and made the peaceful change of government impossible. The limited form of private sector activities depend essentially on the government patronage for survival that has characterized governance in SSA and was a direct result of faulty political arrangements that made government the main organ responsible for the allocation of resources. Costly intervention strategies that brought government into the production of goods and services, the nationalization of strategic industries, the creation of government monopolies, etc., not only expanded patronage activities but equally became a means of rent-extraction (Djankov et al., 2002; Robinson and Torvik, 2005). This exerted upward pressure on the cost of governance. In the face of a political arrangement that must give fair representation to all ethnic groups, irrespective of the distribution of competence across the national space, what the society is forced to bear is a negative externality of incompetent public officers. Everyone is forced to pay for the incompetence of public officers whose marginal productivity may be zero or negative.

The essential features of our model include the following:

- a. a predatory colonial power that planted inefficient institutions for extracting resources from their colonies
- b. due to the unequal distribution of educational opportunities across the regions at independence and the information asymmetry problem it created, it was easy for self-seeking regional leaders to exploit the factor of ethnicity in the contest for political power
- c. the success of politicians who exploited ethnicity and the politics of exclusion, rather than competence to attain political power, which characterized the polity, had significant implications for the cost of running government
- d. the unequal distribution of natural and human resources across the landscape makes it impossible for growth-promoting and developmental market

- institutions to be established, since the benefits might not be widespread
- e. growth-inducing democratic practices and true federalism could also not be established.

#### **4. Possible Cost Reduction Options**

A successful enterprise is judged by comparing the cost incurred and the returns accrued. In this section, we highlight the possible means by which the high cost of running the Nigerian state can be reduced. The following reduction options are suggested.

##### **4.1 Optimal cabinet size**

One of the major costs of governance, is the larger than optimal size of the executive cabinet. It is possible to reduce the cost of governance by ensuring an optimal size of cabinet, where merit and core competence are the primary reasons for appointment to serve in public offices. For instance to have a minister, a minister of state with several special advisers and a permanent secretary, plus many other portfolios in a single ministry is an abysmal waste of scarce resources. A legislative instrument that will reduce to an optimum the number of ministries and the cabinet (because so many of them have interwoven roles) will cut down costs. In fact, we do not think we need a coterie of full time special advisers. Instead, competent individuals engaged on a part-time basis could give well-meaning advice to government. In addition, a part-time legislature will help cost reduction. A case where lawmakers have their business and only come for sittings when there are meetings, will go a long way to reduce the corruption menace and cut down administrative expenses.

##### **4.2 Fiscal federalism**

Fiscal decentralization and federalism is also another possible way to reduce governance costs. There is every indication that when the political zones are adopted as federating units (with states and local governments) costs will be reduced. The near homogeneity, cultural and historical affinity within the zones will ensure stability and good governance. Also the overbearing influence of the central government will be drastically reduced. The internal political and economic autonomy that will ensue will reduce the agitation and aggression that has resulted in colossal waste (Okoye, 2005; Dunmoye, 2002; Alade et al., 2003). This is in line with the findings of Kwon (2003) using the Brennan and Buchanan decentralization hypothesis in which case fiscal decentralization decreased the size of the central budget of South Korea while boosting the viability of the federating units. If ethnic units serve as federating units, we can reduce the costs of governance by avoiding the centralization of activities where co-operative costs will result to pareto-inferior to non-cooperative outcomes (Kimenyi, 2001). Multi-ethnic societies create conflict of interest between voters of different groups and

between their representatives in parliament. This creates the conflict of policy preferences and a bundle of inefficient public policies arrive through logrolling. Appropriate functional decentralization will help to significantly minimize the waste undue centralization causes (Persson, Roland and Tabellini, 2003). Decentralized policy-making units are efficient and are more responsive than central units particularly when there are different preferences, a diversity in economic structure and geographic distances and variations in cultural history (Bednar et al., 1999).

#### **4.3 Separation of powers**

Constitutional provisions for true power separation between the tiers of government will also reduce costs. Thus, independence of the legislative, executive, and judiciary bodies will create a true platform for checks and balances and prevent collusion. The separation of powers checks the abuse of power by making public policy a product of both legislative and executive agreement and puts in check extensive rent-seeking within government (Persson et al., 2003). It sets the bodies in conflict and yet they have to agree on public policy. After six years of quasi-democratic rule in Nigeria, the separation of powers has not actually freed both the judiciary and legislature from the tight grip of the executive. Thus, we suggest that elections into any legislative arm of government at whatever level should be done on zero-party basis. This should remove the need to vote on public policy along party lines, which most often has serious efficiency consequences. The constitutional power of the President to appoint the Chief Justice of the Federation should be withdrawn. Rather the people should elect a chief justice from a number of upstanding and erudite justices. Constitutionally fixed proportions should be allotted to both the judiciary and the legislature. More importantly, vital agencies of the executive should be brought under the direct control of the public they are supposed to serve. Their continuous stay in office should be subject to annual referenda based on their efficiency and effective performance in office. Public office holders such as the Chairman of the Independent Electoral Commission (INEC), the Governor of the Central Bank (CBN), the Inspector General of Police (IGP) and holders of posts in other important government agencies presently under the control of the executive should have their appointments renewed annually through popular referenda. When such a disciplined mechanism exists, the executive would be forced to pick the best hands available for cost efficiency in the delivery of public service. In addition, the judiciary should be made more proactive by allowing it to declare actions or laws of government unconstitutional even when such actions are not brought before it.

#### **4.4 Definition of property rights**

The smooth operation of the free market hinges on the clear definition of property rights. Where property rights are ill defined or not properly protected free market is impeded and slow growth results. The defense of property rights requires a strong and efficient legal system. The Nigerian legal framework needs to be overhauled to achieve speedy and efficient dispensation of justice. An efficient and just legal system will encourage investment since both local and international investors will have a guarantee that property rights violations can easily be corrected through the court of law. Personal rule or arbitrary exercise of power is impossible where the rule of law is firmly established as politicians face severe constraints under a system that drastically reduces the exercise of arbitrary power.

#### **4.5 Political competition**

In our traditional markets, the larger the number of firms the better for efficiency, as prices are driven down and output raised. Competitive pressure in the marketplace is solely responsible for raising output and lowering costs. The same is possible in liberal competitive democracies where many parties compete for political power. Given limited tenure of office, parties in power at whatever level are forced to institute and implement social welfare-enhancing policies. Under this system it is natural to expect little or no rent-extraction from the state. Fiscally wasteful expenditure or growth-inhibiting budget deficits are avoided. Attempts to reduce the cost of financing elections in order to avoid rent-extraction may not prove to be worthwhile. The amount of rent extracted from the state will be less dependent on the cost of winning elections and more dependent on the effectiveness and magnitude of institutional constraints placed on political actors. In fact, politicians seeking political office spend so much because there is a lot of rent to extract. If the rent to be obtained from government could be drastically reduced, political violence will diminish and the incentive to commit a lot of money to elections will be correspondingly reduced. The starting point is the constitutional specification of limited roles for government so that its activities are restricted to areas in which it has comparative advantage. Since periodic elections are central to political competition, fundamental electoral reforms are required to render the political industry truly competitive. Since voting by the people could force non-performing governments out of office, government will be forced to be more responsive to their aspirations. Thus, elections would serve as a device to reward or penalize politicians in power. It has been discovered that private investors are favourably disposed towards countries where politicians face a high risk of being rejected at the polls. The possible loss of office seems to induce policy restraint, which increases investors' confidence in policy stability (Humphreys and Bates, 2002). Political competition could also undermine monopolies (Haber, 2004). In a federation with increased mobility, political competition will inhibit states from raising taxes to unnecessarily high levels or engaging in costly transfer of resources from one group to another. The mere fact

that people and firms could move to states with lower rates will act as a restraint. When property rights in strategic resources are vested in individuals rather than the state, the undue scramble for political power would be greatly minimized. The agitation for resource control and the campaigns against it would be non-existent.

## 5. Conclusion

The question of efficiency in governance is about ensuring that each amount of public funds is spent judiciously. In other words, every naira of public funds must be spent in a way that social, not private, welfare of all is maximized. In the absence of strong political institutions, the reduced cost of governance could only come if a benevolent set of public officers is in power. Since this is highly unlikely, we need to place institutional constraints on public office holders and technocrats in a way that minimizes the extraction of rent from the state. This is the better path to follow if the cost of governance is to be drastically reduced in Nigeria.

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