Political Instability-Development Nexus: Empirical evidence from a small open economy

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ABSTRACT

The uncertainties connected with an unstable political environment may induce negative returns to investment and acceleration of development process. One important theoretical argument essential to this relationship is built on the outcome of uncertainty on productive economic decisions such as production and investment. In analyzing the relationship existing between political instability and economic development, the time-series analytical technique was adopted covering the period of 22 years (1996-2017). The Ordinary Least Square (OLS) technique was adopted, alongside other preliminary test; the unit root and Johansen cointegration test analysis. Thereafter, the Error Correction Method (ECM) was adopted to ascertain the long run relationship. Empirical result revealed that political stability and absence of terrorism showed a negative and significant relationship to real gross domestic product. It is thus recommended that for developing economies to be able to escape this cycle, making the necessary reforms in institutional structure and adapting policies of their own is a necessity confronting them.

Keywords: Political Instability, Development, Environment, Institution Quality, Nigeria

1. Introduction

Institutions exert robust influence on macro-economic performances of economies by means of influencing transaction costs by decreasing uncertainty, re-directing economic activities to productive sectors and by developing trust and enhancing cooperation. The formation, development and effective functioning of institutions vary extensively among economies thus causing differences in development trajectories of countries'; making some countries relatively poor while making others rich Yildirim (2015). Development crisis has been and is still a penultimate issue in development states', coupled with series of contradiction which is prevalent in every facet of every economy, including Nigeria. Currently, the crisis of development poses serious problem due to the fact that the African continent remains largely under-developed amidst abundant human and natural resources. Several decades following the closing stages of colonialism, most economies in Africa including Nigeria are still facing inherent challenges such as basic infrastructural deficit; insecurity of lives and property (Alumona; 2009). For instance, Nigeria, being the most populous African country earning over US$500 billion in oil revenue since the 1970 has remained mired in deepening poverty, rising unemployment, bourgeoning domestic and external debt, infrastructural deficit, abysmal education and health services and attendant unrest and social frustration (Suberu, 2007).

Since the individuals who provide the funds for capital accumulation must be realistically assured that they will be able to acquire the earnings generated by their savings, the security of lives and property is relatively seen as an important determinant of savings and capital accumulation. Increased levels of political violence reduce the security of property rights, leading to a decrease in savings and capital accumulation. In addition, political instability supports capital-flight, including 'brain drain,' and thus discourages the free flow of foreign capital. The quest for stability and development is without doubt, and continues to remain a major concern for many emerging and developing countries; a never ending, yet elusive search for that condition under which these countries would be able to develop institutions and concrete structures with the capacity to ensure growth, equitable distribution of nations' surpluses, political stability and accountability. As scary as they appear, it is probable to bicker that there are certain levels which all economies, emerging and even those which are developing, aspire to reach. Every country seeks to attaining high-quality of life for its citizenry, strong and diversified economic-base, internal cohesion and political stability. How and to what extent these aspirations are attained largely depend on certain critical factors. For one, human and natural resources are fundamental, but the capacity to effectively harness and utilize them is principally the realm of administrative capacity, technological expertise as well as political leadership (Orubu & Awopegba, 2004).

The aim of the study is to examine the relationship between political instability and the development process in emerging economies, with particular reference to the Nigerian economy. Specifically, it attempts to present additional evidence to show that political instability constrains economic development in Nigeria. For easy leeway, the study is structured into five sections. The introductory chapter which gives a general overview of the study is followed by chapter two which reviews relevant literature. Chapter three focuses on the research methodology. Chapter four constitutes empirical analysis; and statistical analysis. The results obtained are interpreted in the same section. Conclusively, chapter five presents the summary of major findings in the research study, policy recommendations of the findings and conclusion.

2. Literature review

2.1 *Africa's political structure and leadership problem*

The political composition and other related issues is today essentially a fundamental consequence of its leadership problem. At internal levels, governments in developing economies are patterned in dimensions which have been regarded as far from modern, upon which they are modelled (Tutu, 2004). However, it should be noted here that leadership is not a new concept to the cultural practices and traditions in developing countries. The context may be dissimilar, but systems of governance had characteristics which can be exemplified in modern systems of governance. These internal factors have contributed appreciably in shaping economic and political transitions in Nigeria. As argued by O'Donnell and Schmitter (1986), 'Domestic factors play leading role in this transition'. These domestic factors repeatedly range from 'corrupt rulers, repression, a colonial legacy, 'swollen' states, and inefficient political arrangement and the obliteration of democracy from above (Diamond, Linz & Lipset, 1989; Lipset (1989). However, the international contexts seldom play an important role in the transition and the presence of violence in particular (Lupo, 2004). Conversely, Linz & Stepan (1996) stress the relevance of 'international influences', which includes foreign-policies and the distribution effect which adversely affect the stability of developing countries. Nonetheless, positive developments have witnessed the reversal of some of these negative situations in terms of people involvement in bringing change. For this rationale, many economies have witnessed increased level of political awareness, as citizens are demanding full accountability of their governments.

The pace is somewhat slow and occasionally experience setbacks, particularly by the few remaining big guns, including Nigeria. However, it is important to be cautious about these developments, as global events keep unfolding, thus generating new challenges for the African economy. In this regard, concerted efforts towards fast-tracking critical political processes, establishment and formation of institutional and legislative frameworks that can withstand international and domestic pressures, needs to be sped-up. The political stability generated from these framework and re-distributive systems is therefore critical to Africa's development.

2.2 Comparative analysis of institutional structure in emerging/developing economies

Institution-developing countries are usually plagued by lack of ample activity in supporting-productive investments and at the same time solving the low-efficiency problem. The effect of institutions on development performance takes shape in relation to the qualifications present (Edison, 2003). The immaturity of bureaucratic institutions performing economic-operations increases the cost-of-doing-business. Particularly in Latin-America and Africa, the fundamental weakness in terms of growth and development is the political institutions arrangements, which are usually inconsistent with the interests of its citizens, thus providing irrelevant public services. In aforementioned regions, the applicability and reliability of contracts are limited. The uncertainties and manipulative white-spaces in the judicial system, bribery, ill-defined property rights, tax evasion and the existence of in-efficient institutions causes those countries to become risky and unattractive (Luiz, 2009; Fosu, Bates & Hoeffler, 2006; Baliamoune,2005; Birdsall, 2007; Charnock, 2009).

According to the data on the table 2.1; Taiwan and Chile draw attraction as emerging countries having the strongest institutional structure in relation to all six institutional indices while Nigeria and Venezuela are having the weakest institutional structure from all six indicators of institutional quality. According to table 2.1, while Taiwan and are at a more successful point in being politically stable, Nigeria and Venezuela have displayed a bad performance. The data contained in table 2.1 reflects the weakness of institutional structures in developing and some emerging countries. Nevertheless, when the aforementioned countries are appraised among themselves, the striking-point is that, Taiwan always takes precedence among the stronger nations in terms of institutional development, while Nigeria and Venezuela are always among countries with increasing weak institutional development.

Table 2.1: Institu tional Indicators in Developing/Emerging Countries (2017)

	Asian Economies			*African Economies*			*Latin America (Majors)*		
	China	*India*	*Taiwan*	*Nigeria*	*Senegal*	*Egypt*	*Venezuela*	*Brazil*	*Chile*
Voice and Accountability	-1.45	0.38	0.98	-0.41	0.24	-1.28	-1.41	0.39	1.05
Political Stability and Absence of violence	-0.26	-0.96	0.85	-2.19	-0.09	-1.16	-1.34	-0.36	0.43
Government Effectiveness	0.48	0.28	1.36	-1.02	-0.27	-0.58	-1.58	-0.45	1.08
Regulatory Quality	-0.14	-0.18	1.36	-0.88	-0.11	-0.87	-2.33	-0.31	1.34
Rule of Law	-0.20	0.03	1.11	-0.88	-0.21	-0.41	-2.34	-0.28	1.12
Control of Corruption	-0.27	-0.19	1.03	-1.04	-0.02	-0.59	-1.47	-0.42	1.01

Source: World Governance statistics; *N.B: Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performances)*

2.4 Empirical Review

Relevant literature as regards political instability and other institutional performance index and economic development nexus are summarised in the table 2.2

3. Research Methodology

This section empirically describes the procedures employed for the analysis of data. The core purpose of employing this method is to facilitate a comparison of our results with those of other cross section studies in the recent literature such as those of Barro (1991). Despite the probable draw-backs mentioned experienced in several literatures, if adopted accurately, the time-series analysis presents the advantage of revealing dynamic changes which occurs within an economy due to policy (political) and development interactions. Such analysis was conducted by Burkhart & Lewis-Beck (1994), Przeworki et al. (2000) and Gasiorowski (1995). As a quantitative model, the time-series approach of analytical methods was adopted (Barro, 1991, 1996; Przeworki, 2000; Feng, 2003) with relevant modifications. The multivariate equation is thus:

$$g_t \qquad x_t \qquad y_t \qquad {}_t \qquad (1);$$

The variable t refers to the time-period, x represents sets of economic variables adopted in the model, y represents sets of institutional index (political instability) which determines the occurrence of government change with a mix of economic-variables which will capture the interplay of policy variables on other variables, and ε is the error term. In its explicit form;

$$RGDP_t \qquad {}_0 \qquad {}_1POLS_t \qquad {}_2INF_t \qquad {}_3GDS_t \qquad {}_t \qquad (2);$$

Where

RGDP **= Gross Domestic Product per capita (measured in millions)**

POLS **= Political Instability and absence of violence (Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performances)**

INF **= Inflation rate (measures in percentage)**

GDS **= Saving rate (percent of GDP)**

$_1 \quad _3$ **= coefficient of parameters**

$_t$ **= error term**

Table 2.2: Summary of related literature review

S/N	*Authors*	*Period*	*Country(ies) Studied*	*Results*
1	Grossman and Elhanan (1991)	1960-1990	118 market economies	Institutional struc ture has a meaningful and significant impact on economic growth
2	Amja and Yeats (1995)	1950-1982	113 countries	The impact of democratic institutions was not found significant to the economic development
3	Ali & Crain (2002)	1975-1989	119 countries	Aside from economic freedom, political regimes and civil freedom was found to be insignificant to growth.
4	Dollar and Kraay (2003)	1980-2004	102 countries	There is minimal evidence to suggest that institutions have negative impact on development
7	Asiedu (2005)	1984-2000	22 African countries	The countries can attract more FDI by less corruption, political stability and good legal system
8	Busse & Carsten (2007)	1984-2003	83 developing countries	Democratic rights, government stability and ensuring law and order are highly significant determinants of FDI
9	Lindert (2004)	1984-2002	145 countries	Corruption must be analyzed as a directly unproductive profit seeking activity, such as tariff evasion or smuggling
10	Fabro and Aixalá (2009)	1996-2000	145 countries	Institutional quality was found to exhibit significant effect on economic development level in high income countries than in poor countries within the specific limit
11	Valeriani & Peluso (2011)	1950-2009	181 countries	Institutional quality had a pos itive effect on economic growth. The magnitude of the effects differs when considered in terms of emerging and developing countries
12	Fayissa & Nsiah (2013)	1995 to 2004	39 SSA countries	Their results suggested that all governance indicators had signific ant effects on per capita income growth of SSA countries, such that the magnitude and significance of this impact depends on the proxy of good governance indicator used.
13	Orubu C.O (2013)	1996-2012	35 countries (20 African countries and 15 others)	The findings reveal that countries with relatively strong degree of effective government exhibit upward intercept shifts, thus underscoring the relevance of the role that governments could play in reducing the level of corruption in the economy
14	Leyaro (2016)	1996 to 2012	46 SSA countries	His finding shows that institutional improvement matters for the recent growth in Africa.
15	Oluwatoyin and Folasade (2014)	1985 to 2012	30 SSA countries	Their findings reveal that institutions have significant effect on gr owth while openness only has little significance on economic growth in the selected SSA countries.
16	Kilishi, Mobolaji, Yaru, & Yakubu (2013)	1996 to 2010	36 SSA countries	Their findings reveals that institutions really matter for SSA economic performanc e, among which regulatory quality and rule of law appeared to be core and as such, economic performance of the region could be enhanced by improving these institutional development indicators.

Source: Author's Computation

Table 2.2 (contd.): Summary of related literature review

S/N	*Authors*	*Period*	*Country(ies) Studied*	*Results*
17	Zureiqat (2005)		25 countries (Africa, Eastern and Central and Europe, Latin -America, the Middle -East, and South-East Asia)	The empirical results confirmed that the measured ins table indices had significant impact on growth of the economies of these countries
18	Farida and Ahmadi (2008)		Lebanon	The results revealed that corruption has adverse and indirect effect on GDP
19	Aisen & Veiga (2013)	1960-2004	169 nations	The study fo und that political instability was dependent on gross domestic product in the economy. The lower the rate of growth of GDP, the greater the stability of political systems.
20	Kaplan & Akçoraoğlu (2017)	1984-2012	28 countries	The results also found that political-instability has a depressing effect on growth levels, while democracy had no significant impact on the growth of such countries

Source: Author's Computation

Table 3.1: Definition and Nomenclature of variables

S/N	*Variables*	*Definition*	*Expected sign*	*Source*
1	***Per capita GDP (RGDPg)***	This indicates the individual performance of the economy. And as such, the higher the per capita GDP, the better the quality of life.		World Development Indicator
2	***Political stability and absence of violence (POLS)***	It measures perceptions of the likelihood of political instability and/or politically -motivated violence, including terrorism, as the value ranges from approximately -2.5 (weak) to 2.5 (strong) governance performances.	Negative (-)	WDI
3	***Inflation rate (INF)***	The effect of price change on development depends on the trade -off between the variables which the economy can achieve.	Negative (-)/ Positive(+)	WDI
4	***Savings rate***	Savings is expected to have a positive effect on growth. Support for this intuition can be observed in Lewis's (1955) traditional development theory which showed that increasing savings would accelerate growth	Positive (+)	World Development Indicator

Source: Compiled by Author

4. Empirical Results

The empirical analysis commences with the trend analysis which is adopted to buttress the of policy variables as it affects the functioning of the economy under the period of review. For long run analysis under the Johansen cointegration test analysis is conducted after testing for the unit root.

Trend Analysis

The graphical analysis in figure 1a and 1b captures the trend analysis for each variable which include real gross domestic product, political stability and absence of violence, inflation rate, and gross domestic savings as a ratio of GDP. From the trend analysis, it is seen that political stability and absence of terrorism which is used as a core policy variables show decline overtime. This implies that policies have had negative effect on its target variables which include both growth and developmental variables. It is generally said that an unstable economy throws off unstable data which reflects in the performance of the economy. This is typical to the Nigerian economy.

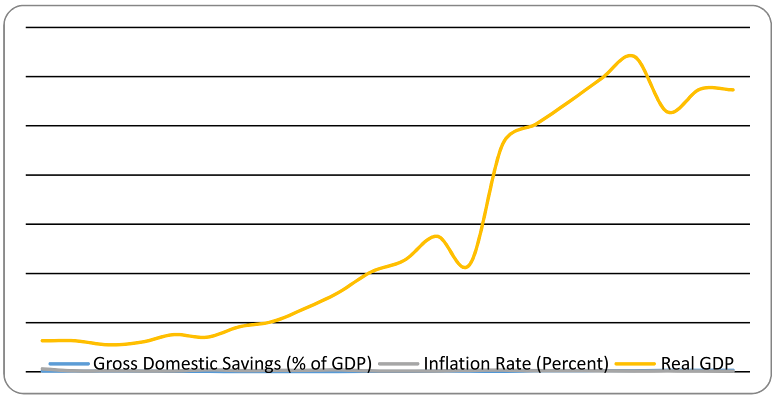

Figure 1a: Trend analysis of Macroeconomic Variables for Nigeria

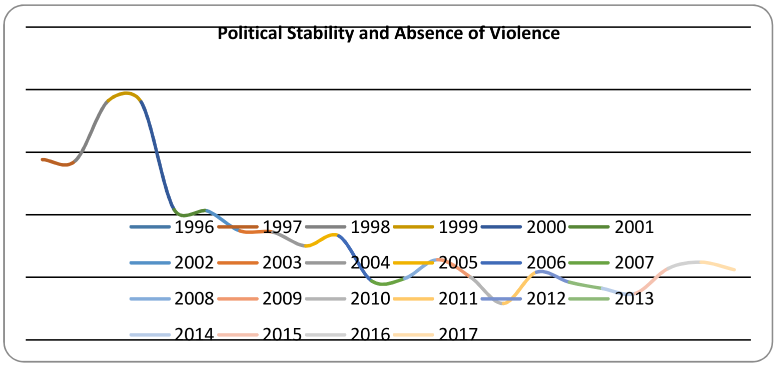

Figure 1b: Trend Analysis of Political Statbility and Absence of Violence for Nigeria Descriptive Statistics

The descriptive statistics of the variables shows that economic growth has a mean value of (6.89) with maximum and minimum values (8.07) and (6.95) respectively. The implication of this is such that the economy on the average can experience growth greater that is current mean value. The standard deviation of (0.91) suggests that there is little or no deviation in the true relationship as expressed by the mean value. Gross domestic savings has a mean value of (7.03) with maximum and minimum values (15.04) and (1.48) respectively. The implication of this result suggests that gross savings can increase far above the mean value and can also experience low decline. Political stability and absence of terrorism has a mean value (-1.68) with maximum and minimum value (-0.59) and (-2.21). The implication of this is that the political structure and policy structure overtime have yielded negative outcome on the average. Its impact on the economy could be far deteriorating as seen by the maximum value.

Table 4.1: Summary Statistics for period (1996-2017)

	RGDP	***GDS***	***INF***	***POLS***
Panel A: Descriptive Statistics (level value)				
Mean	1413.227	7.039	11.521	-1.680
Median	1053.352	6.538	9.750	-1.870
Maximum	3203.244	15.045	29.300	-0.590
Minimum	273.869	1.485	5.070	-2.210
Std. Dev.	1099.156	3.764	5.585	0.470
Jarque-Bera	2.797	1.598	15.033	5.441
Probability	0.246	0.449	0.000	0.065
Panel B: Descriptive Statistics (natural log value)				
Mean	6.894	1.797	2.350	-
Median	6.959	1.873	2.276	-
Maximum	8.071	2.711	3.377	-
Minimum	5.612	0.395	1.623	-
Std. Dev.	0.914	0.602	0.430	-
Jarque-Bera	2.265	1.198	0.937	-
Probability	17.563	7.624	3.893	-
Panel C: Correlation Matrix				
	RGDP	***GDS***	***INF***	***POLS***
RGDP	1			
GDS	0.709**	1		
INF	-0.368	-0.406	1	
POLS	-0.706**	-0.137	0.161	1

Source: Author's Computation using E-views 10

Table 4.2: Stationarity Test

0.1		***At level***		***First Difference***			
		ADF (prob.)	***PP (prob.)***	***ADF (prob.)***	***PP (prob.)***	***DW***	***Decision***
RGDP	(-4.467)* (-3.644)** (-3.261)***	-2.308 (0.411)	-2.255 (0.437)	-5.331 (0.001)**	-5.322 (0.002)**	1.93	I(1)
GDS	(-4.532)* (-3.673)** (-3.277)***	-0.842 (0.942)	-0.356 (0.982)	-5.532 (0.001)**	-7.986 (0.000)**	1.91	I(1)
INF	(-4.467)* (-3.644)** (-3.261)***	-5.268 (0.002)**	-5.086 (0.002)**	-6.899 (0.000)**	-17.733 (0.000)**	2.25	I(1)
POLS	(-4.467)* (-3.644)** (-3.261)***	-1.936 (0.600)	-1.916 (0.610)	-5.418 (0.002)**	-8.754 (0.000)**	1.88	I(1)

Source: Author's Computation using Eviews 10

Table 4.3: Johansen Co-integration test for model

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized No. of CE(s)	***Eigen-value***	***Trace Statistics***	***0.05 Critical value***	***Prob. (**)***
None*	0.750	48.179	47.856	0.046
At most 1	0.396	20.399	29.797	0.396
At most 2	0.261	10.313	15.494	0.257
At most 3*	0.191	4.251	3.841	0.039
Unrestricted Cointegration Rank Test (Maximum Eigen Value)				
Hypothesized No. of CE(s)	***Eigen-value***	***Trace Statistics***	***0.05 Critical value***	***Prob. (**)***
None*	0.750	27.779	27.584	0.047
At most 1	0.396	10.085	21.131	0.736
At most 2	0.261	6.062	14.264	0.605
At most 3*	0.191	4.251	3.841	0.039

Source: Author's Computation using E-views 10

From the correlation analysis, political stability and absence of terrorism show negative relationships to gross domestic savings with correlation coefficient (-0.137). This implies that political instability affects domestic savings negatively. With regards to change of government and policy inefficiency, bulk of the country's resources is being wasted and underutilized leading to a decline in per capita income and having a multiplier effect on the savings and consumption function. And once savings reduces overtime, this affects the investment position of the economy.

Unit root Test

The Augmented Dickey Fuller (ADF) unit root test was adopted to access whether or not the variables are stationary and their order of integration. The result of the ADF unit root test is shown below;

The result of the ADF unit root test for gross domestic savings, real gross domestic product and political stability were originally non-stationary but became stationary at first difference. Other variables such as inflation rate and political stability and absence of terrorism were stationary at level, I (1). This thus permits us to proceeds to the next stage which is the cointegration test.

Cointegration Test

The Johansen methodology which has the advantage over other cointegration techniques will be used to test for the long-run relationship among the variables. A key advantage is that it allows for more than one cointegrating equation. The result of the Johansen cointegration test is shown in the table 4.3 below;

The guideline for selecting or deciding whether co-integration exist or not is that if the probability value is greater than 0.05, then we accept the null hypothesis, implying that there is no co-integration among

Table 4.4: Inferential Statistics

Variable	Coefficient	Std. Error	t-Stat.	Prob.
Panel D: Ordinary Least Square (OLS) Estimates				
GDS	0.663	0.122	5.413	0.000**
INF	-0.100	0.171	-0.584	0.566
POLS	-1.556	0.138	-11.236	0.000**
C	3.321	0.603	5.498	0.000
R-Squared = 0.909				
Adjusted R-Squared = 0.894				
D.W Stat. = 1.777				
Panel E: Over-Parametized Estimates				
LNGDS	-0.094	0.215	-0.439	0.667
LNGDS(-1)	0.764	0.251	3.035	0.010**
LNGDS(-2)	-0.080	0.165	-0.488	0.633
LNINF	-0.155	0.181	-0.855	0.408
LNINF(-1)	0.242	0.194	1.251	0.234
POLS(-1)	-1.551	0.127	-12.145	0.000**
ECM(-1)	-0.860	0.229	3.752	0.002**
C	3.131	0.676	4.631	0.000
R-Squared = 0.963				
Adjusted R-Squared = 0.942				
Schwarz criterion = 0.405				
Akaike info criterion = 0.007				

Source: Author's Computation using E-views 10

the variables. From the table above, given that the lag length selection criterion chosen is 2, from the trace statistics, a long-run relationship exist between the variables. This is because the prob. (value) for the co integrating equations is less than 0.05. From the trace statistics, it shows that there exist two (2) cointegrating equation. The same holds using the maximum-Eigen value, which implies that there exist two cointegrating equation and there exist a long-run relationship between the variables being specified. The result from both the trace statistics and Max-Eigen statistics suggests a long run relationship among the variables.

Inferential Statistics (OLS and Over-Parametized Error Correction Method (ECM) Results)

The Ordinary Least Square and over-parametized ECM result involving two (2) lags of each independent variable is presented in table 4.4 below;

The R^2 indicates that 96 percent of the total variation in economic growth has been explained by the changes in political stability and absence of terrorism, inflation rate, and gross domestic savings. The result further shows that political stability and absence of terrorism at lag one shows a negative and significant relationship to economic growth with probability value (0.000) less than 5 significant level. The implication of this is that for every policy at any point of administration initiated and targeted towards improving the performance of the economy ends up contributing negative to the development of the economy and this distortion or non-performance of these policies affects the economy significantly. Therefore, policy instability erodes developmental stride of the economy. Gross domestic savings at the current period shows a negative and insignificant relationship as compared its previous value which shows a positive and significant relationship to economic growth with probability value (0.094). The implication of this relationship is that the workability of quality institutions can effectively translate policies into productive outcome, but in situations were there is absence of quality institutions, positive outcomes experienced in previous periods can be rendered null and void. So policy shifts affect the performance of variables in the economy which describes both the short run and long run periods. The result of the Error Correction suggests that the short-run to adjust to the long-run period by 86%.

1. Conclusion and Recommendation

Most solutions which have been prescribed in recent times seem to view Nigeria through the prism of the natural-resources and the competition to acquire the benefit of their exploitation intervention (interventionist approach). However, what needs recognition is the fact that the economy is beginning to see the emergence of new social actors, different form of social and political mobilisation. In the process, the political and economic play field is also changing. Long term solutions to instability problems will basically be determined by a new type of leadership where policy issues whose repercussions heavily impact on the development of the Nigerian economy and other developing economies are made. Although much expectation is placed on the leadership structure which serves as a solution to its perennial problems, partners within the developing regions and also in the developed regions need to realise that marriage between these regions, whether through default or reinforced further by an integrated global economy and human security concerns, demand an in-depth understanding of its interest, which in essence require supporting Nigeria to lead itself. Key to this process is strengthening the domestic institutions that promote democracy and accountability with an input from the local perspectives. The persistent ignorance of developing nations views on how they crave to solve their problems, inform the missteps that continue to bug economic and political policies, often peddled as good for the economy.

In terms of development in Nigeria, a most valuable offshore asset of developing regions is the human, and social and intellectual capital (i.e policy and managerial expertise) possessed by the Diaspora (ADPC, 2008). Such potentials can be of greater value to the on-going development initiatives but also to the advantage of destination countries. However, it is the policies prescribed for the economy from the developed regions that is likely to reverse these trends, if coupled with domestic and international visionary leadership, political will and its influence on its institutions.

Based on our findings, governments should employ policies to promote political stability to improve economic development. However, as stated earlier on, ineffective and inefficient institutions are basically the limitation to policy stability. As such, it is recommended that efficient institutions must be put in place so as to improve policies for the development of the economy.

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