Chapter 6

Economic Diversification and Inclusive Growth in Nigeria:
Does Institutional Quality Matter?

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ABSTRACT

Economic diversification is identified as a recipe for achieving inclusive growth and the role of institutions in strengthening the process of diversification cannot be ruled out. This study examined the role of institutions in helping economic diversification to achieve inclusive growth in Nigeria. Inclusive growth was measured using the growth rate of the inequality-adjusted human development index. Based on the Solow growth model and adopting the Johansen cointegration test, the results show that economic diversification in Nigeria does not significantly contribute to inclusive growth. The interaction of diversification with the institutions gave a positive significant result meaning that effective institutions will help economic diversification contribute to inclusive growth. Hence, the government using appropriate institutions can ensure an investment-friendly environment to support economic diversification and encourage inclusive growth in Nigeria.

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BACKGROUND AND JUSTIFICATION

In any country's development matrix, economic diversification, institutional quality and inclusive growth are significant variables. Developed countries of North America, Europe and the Asian Tigers have shown that economic diversification is necessary for inclusive growth. But, developing countries, especially for countries dominated by primary products, economic diversification remains one of their biggest economic challenges (World Bank, 2019). Nigeria is blessed with abundant human and natural resources such as crude oil, natural gas, lead, coal, and so many others. The country's superior climatic conditions are viable for agricultural proceeds including cocoa, groundnut, tobacco, oil palm and different live stocks.

The availability of the different resources and introduction of technology gave rise to industries such as oil and gas, furniture, construction and building, food and beverages. Slowly, growth became pronounced in the production of consumer goods. Hence an economy which depended on agriculture delved into industrialisation which boomed despite many infrastructural challenges. Industrialisation is identified as the key object to the economic development of any nation and by the 1970s, oil became the biggest foreign exchange earner and completely replaced palm products, groundnut, cocoa and hides and skin (Oyebola et al, 2020; Adeleye et al, 2020). The oil boom of 1974 led to an increase in revenue and flood of wealth, resulting in a structural transformation of the Nigeria economy from a third world country to an appreciable position in terms of development and international politics (Oparah, 2018). Much of the revenue which was intended for investment and to diversify the economy also spurred increased government expenditure, inflation and inequalities in the country.

Nigeria continued to rely on a single source of revenue which exposed the economy to macroeconomic instability (Metu, Maduka, Eze & Ajudua, 2019). The oil boom was short-lived as the 2008 global economic crisis crashed commodity prices, including oil. Brainard and Cooper (1968) argued that countries rich in natural resources, such as oil, are more vulnerable to economic fluctuations especially high level of primary product export concentration. Similarly, the collapse in crude oil price coupled with low productivity contracted the average annual growth rate of GDP and the country witnessed another recession after 25 years (World Bank, 2019). Economic diversification in developing countries is linked with the structural transformation of their economies and the achievement of higher levels of productivity as a result of the movement of economic resources within and across different sectors.

Before the recession, despite the growth trajectories for almost 15 years, there was little economic development even with the rebasing of the GDP at 2010 constant prices, the structure of the economy remained undiversified; peasant agriculture dominates the economy, manufacturing contributes less than 10% to GDP while the 50% contribution of the services sector to GDP needs to be interpreted with caution (Ekpo, 2016). Data also shows poor economic performance indicator was less than 80% while both unemployment and underemployment averaged 27% in 2015 (National Bureau of Statistics, 2016).

The oil price volatility has frequently led the country's resource expectation into avoidable difficulties resulting in the resurgence of calls for the diversification of the Nigeria revenue base. This is not the first discussion or call on the Nigerian government to embrace economic diversification as a tool to stabilize the Nigerian economy, but the recent economic crises resulting from the decline in global oil prices have heightened the call. Some of the difficulties developing countries experience in attempts at economic diversification include poor infrastructure, poor macroeconomic policies and weak institutions. Economic and political institutions raise business confidence and encourage the improvement of new business activities by generating a friendly investment atmosphere and environment (Cramer, 1999).

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