British Journal of Economics, Management & Trade
5(3): 258-272, 2015, Article no.BJEMT.2015.022
ISSN: 2278-098X

SCIENCEDOMAIN ***international***
www.sciencedomain.org

Informal Institutions: The Binding Constraint on Institutional Efficiency in Nigeria

Lionel Effiom[1*] and Peter Ubi[1]

[1]Department of Economics University of Calabar, Nigeria.

Authors' contributions

This work was carried out in collaboration between both authors. Author LE designed the study, performed the statistical analysis, wrote the protocol and wrote the first draft of the manuscript. Author PU managed the analyses of the study and the literature searches. Both authors read and approved the final manuscript.

Article Information

DOI: 10.9734/BJEMT/2015/12243
Editor(s):
(1) Stefano Bresciani, Department of Management, University of Turin, Italy.
Reviewers:
(1) Ehsan Rasoulinezhad, University of Economic Sciences, Iran.
(2) Ogbuagu, Anuli Regina, Department of Economics, Nnamdi Azikiwe University, Awka, Nigeria.
(3) Bui Trinh, National Account Department, General Statistical Office, MPI, Vietnam.
Complete Peer review History: http://www.sciencedomain.org/review-history.php?iid=701&id=20&aid=6493

Original Research Article

Received 24th June 2014
Accepted 19th August 2014
Published 11th October 2014

ABSTRACT

This paper contributes to the debate on the relevance of institutions to economic development in Nigeria. Based on the taxonomy of institutions into informal and formal elements and the seeming overemphasis on the latter, the paper extends the argument further by stressing that Nigeria does not have a dearth of formal institutions, but rather that it is the preponderance of the negative informal institutional characteristics that compromises the efficiency of formal institutions. Consequently, the greater the fossilization of these undesirable informal institutions within the greater segments of the population, the greater the manifest inefficiency of any formal institutional rules or mechanisms superimposed on the society. Thus the informal is a binding constraint on formal institutional efficiency in Nigeria. These constraints must be relaxed through plurality of approaches; the government must play a leading role in socio-economic re-engineering. The focus must be on how to secure a durable political economic equilibrium that will dictate better institutional outcomes.

Keywords: Informal institutions; formal institutions; binding constraint.

JEL classification: EO2

**Corresponding author: Email: leoeff2002@yahoo.com;*

1. INTRODUCTION

The literature on institutional economics is replete with the notion that efficient institutions complementarily guarantee better development outcomes. For instance [1] argues that the lack of strong institutional framework is responsible for the parlous state of the Nigerian economy. Institutions in this regard have been conceptualized in tandem with [2,3] to mean the formal and informal constraints on political, economic and social interactions; the rules, enforcement mechanisms and organizations, compliance procedures, moral and ethical behavioural norms designed to *constrain* the behaviour of individuals in the interests of maximizing the wealth or utility of principals". Institutions encompass "the public bodies through which the state discharges its most fundamental responsibilities, maintaining law and order, investing in essential infrastructure, and raising taxes to finance such activities" [4,5].

It is thus evident that while common notions on institutions are dichotomized into informal and formal elements, there seems to be an overemphasis on the latter, with the attendant belief that if relevant laws are made to deal with the various malaises plaguing the Nigerian society, then the economy will be on the path of sustainable growth. This paper however extends the argument further. While formal institutions proceed from the State, informal institutions are a function of the society as a whole. It emanates from the totality of a people's history, what it values and cherishes, what it transmits as traditions and culture from one generation to another. In short, they are basically transcendental moral and spiritual structures that form the subjective basis of the socio-economic existence of a people. They cannot be decreed by fiat into existence; rather the formal mechanisms somehow proceed from it.

We argue that there is no dearth of formal institutions to tackle the myriad of socio-economic problems facing Nigeria. From the Constitution to the various State and Federal enactments-the EFCC ACT, Freedom of Information Act, Electoral Act, ICPC Act, Fiscal Responsibility Act, the Criminal Code Act, the Highway Code, Child's Right Act, etc.–to the often-times duplicated statutory bodies established to oversee different sectors of the economy, there is a preponderance of legislative and institutional platforms to constrain human behaviour to act in acceptable standards. With the EFCC in place, corruption thrives brazenly in government and private sector undertakings; the laws against examination malpractice are still extant, but examination malpractice continues to surge unabated; with the legislature and judicial arms of government in place, oversight functions on the executive are undermined, while persons of notorious public criminal records are acquitted senselessly by the judiciary. These negative scenarios are endless. In the light of these explorations, many questions engage our attention, namely: why are our formal institutions and enforcement mechanisms not effective? Is there a nexus between formal and informal institutions within the Nigerian context? Which sustains the other? Is it the formal that guarantees the sustenance and durability of the informal or otherwise, or are they mutually re-enforcing paradigms? Which of these divides should capture the attention of Nigerian policy– formal or informal institutions, or both? In the sections that follow, we adopt a theoretical and descriptive methodology in attempting answers to the above questions.

Following this introduction, section2 provides some conceptual explorations on institutions, their taxonomies and the complex web of interactions amongst them. Section 3 inquires as to whether economic development is conditioned only on formal institutions, and section 4 discusses the basis of institutional efficiency. The dynamic interactions between formal and informal institutions are evaluated in section 5. While section 6 considers the issues of policy optimality or policy preferences, section 7 concludes the work with some recommendations.

2. CONCEPTUAL EXPLORATIONS

A basic assumption of neoclassical growth theory stipulates that economic growth takes place by a combination and accumulation of capital and labour, each capable of being substituted for each other. More formally: $Y = A f(L, K)$. Where Y = economy's output, K = capital, L = labour and A = the efficiency parameter called technical progress. It represents the efficiency with which capital and labour are utilized. Without technical progress, and given the assumption of diminishing marginal returns to capital, economic growth would eventually come to a halt in spite of credible government policies to alter any declining trend of growth. This is the fundamental deficiency and critique of exogenous growth theory which has given way to the now popularized endogenous growth. The strength of the latter lies in the fact that even in the face of declining returns to labour and capital inputs, the presence of A (i.e. technical progress) would continuously push the production possibility curves of economies outward, since it can be explained within the model. But technical progress, it has been variously shown, depends on the strength of institutions. Perhaps it was this decisive role of institutions which [6] and [1] referred to when they stressed that the quality of institutions can affect technical progress, and [7] affirms that the rate of technical progress is no longer constant across countries, but depends on country-specific institutional differences.

[2] defines institutions as the formal and informal constraints on political, economic and social interactions. They are the rules, enforcement mechanisms and organizations. Institutions are the incentive systems that structure people to behave in certain ways; and if they are effective, they structure economic, political and social activity and provide incentives to the market. They enhance predictability and reduce uncertainty in socio economic relations. They are the humanly devised constraints that shape human interactions. Such constraints are contrasted with potential fundamental causes like resource endowments which are beyond human control.

Incentives, however, are not enough. It is just one side of the prism through which an ideal society should be mirrored; disincentives are the other. Disincentives are a set of restraint on our base human instincts which decries decency, civility and the lawful order. Self-interest often translates to selfishness, greed, avarice and the rabid accumulation of wealth (corruption) often exceeding the moral boundary. Institutional failure occurs when as a result of corrupt practices, service delivery by public and private bodies increase uncertainty. Disincentives guarantee the existence of the weak side by side with the strong in the same society. Simply put, it confers responsibility on economic players, that they shall be held accountable for their actions. Responsible behaviour is the goal of disincentives.

The taxonomy of institutions encompasses those defined in terms of their speed of change (i.e. they may be slow or fast moving), their sphere or arena of operation (i.e. social, political, economic and cultural), and the degree of formality–i.e. whether formal or informal [8]. Clearly, a distinction should also be made between rules governing behavior outside official channels (informal institutions) and culture. [9] recognizes a close association between 'constitutive' and 'regulatory' effects of culture and informal institutions. The former relates to aspects of culture that shape economic behaviour by guiding relative valuation, categorizations and understandings of economic processes and consequences, which have generational persistence via parents, peer groups and schools.. The regulatory effects refer to the way in which the values and beliefs of a society are manifested through social norms and attitudes in ways that regulate behavior: promises must be kept, contracts must be honoured. By and large, the Constitution of a State is the foremost mechanism upon which all other legislations are built. It is the grund norm, the objective basis upon which the validity of all other acts, laws, decrees, edicts, byelaws, subsidiary legislations, etc., can be tested. The society and State itself is the creation of the law or constitution.

But institutions are not easy to concretize or measure. Institutional and political economists have developed several measures for it, ranging from the quality of political regimes and institutions to the legal frameworks established by the political class to reduce frictions, tensions and corruption in business contractual relations (See for instance the works of [10-12]). Other measures include political instability, political and civil freedom and the characteristics of democracy [13-17]. Again, empirical measures of institutions known in the literature include first, the quality of governance, including the degree of political rights, governance efficiency, corruption, and regulatory burdens; second, the extent of legal protection of private property and how well such laws are enforced; third, the level of institutional and other limits placed on political leaders; fourth, measures of social capital, which captures the intensity of social participation and organization; and fifth, measures of social compositions, religious, ethnic, historical and cultural, elements for instance [7] asserts that the terms politics and institutions encompass a wide range of indicators, including institutional quality (the enforcement of property rights), political instability (civil wars, coups, riots), contents and features of political regimes (elections, constitutions, executive powers), social capital (the extent of civic activity and organizations) and social characteristics (differences in income and in ethnic, religious and historical background).

A more recent indicator of institutions is contract intensive money (CIM) defined as the ratio of non-currency money to the total money supply, or (M2-C)/M2, where M2 is broad money supply and C is currency held outside banks. CIM is a proxy for property rights and contract enforcement [18]. Thus it is therefore not difficult to appreciate the onerous task of disentangling the specific effects of each institutional measure on economic growth and development.

Table 1 presents data on the several governance indicators for Nigeria developed by [19]. These indicators show the degree to which a country's citizens are able to engage and contribute in selecting their government, including freedom of association, freedom of expression, and a free media. The estimates are gradated from -2.5 (weak) to 2.5 (strong). It is apparent that Nigeria is weak in all the measures.

Fig. 1 graphically puts the entire institutional scenario into context. Clearly, political instability constitutes the greatest source of institutional disequilibrium, and this is in spite of Nigeria's return to civil rule since 1999.

Table 1. Governance Indicators for Nigeria (1996 – 2012)

	Voice account ability	Political instability	Govt effective ness	Regulatory quality	Rule of law	Control of corruption
1996	-1.66	-1.17	-0.98	-0.82	-1.26	-1.15
1998	-1.22	-0.69	-1.12	-0.93	-1.27	-1.07
2000	-0.58	-1.52	-0.96	-0.74	-1.10	-1.13
2002	-0.71	-1.70	-1.06	-1.23	-1.48	-1.33
2003	-0.64	-1.65	-0.96	-1.24	-1.52	-1.32
2004	-0.77	-1.72	-0.91	-1.32	-1.43	-1.30
2005	-0.84	-1.65	-0.88	-0.77	-1.36	-1.16
2006	-0.64	-2.04	-0.96	-0.89	-1.08	-1.07
2007	-0.64	-2.01	-1.04	-0.86	-1.07	-0.98
2008	-0.76	-1.86	-0.97	-0.78	-1.06	-0.81
2009	-0.87	-1.95	-1.20	-0.73	-1.16	-0.98
2010	-0.80	-2.19	-1.15	-0.71	-1.17	-1.00
2011	-0.74	-1.95	-1.08	-0.67	-1.21	-1.12
2012	-0.73	-2.05	-1.00	-0.72	-1.18	-1.13
Total	11.61	24.16	14.27	12.41	17.38	15.56

Source: [20]

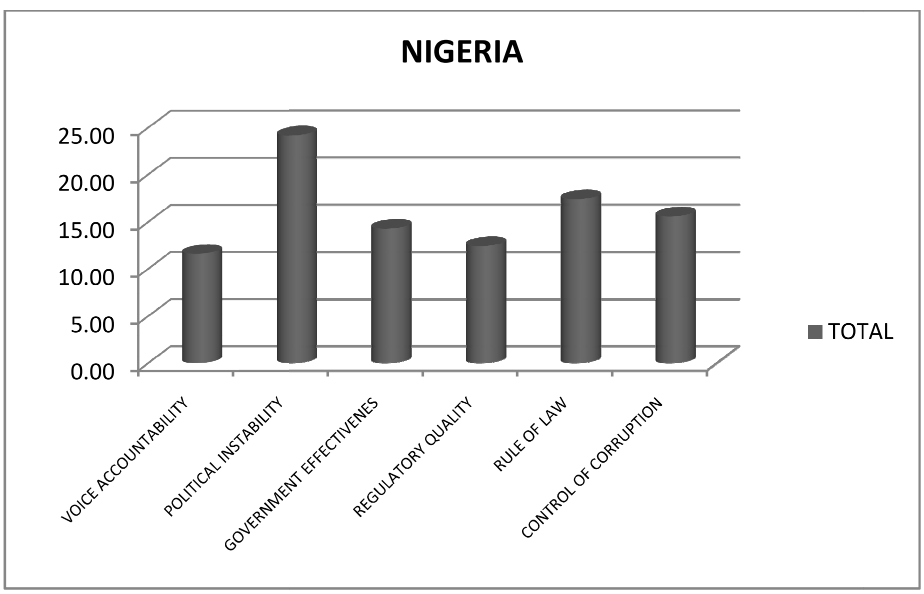

Fig. 1. Governance Indicators for Nigeria (1996 – 2012)

Citizens still perceive the polity as unstable, made worse by the raging insecurity situation in the country. The data further reinforces the thesis that institutional efficiency is conditioned upon the nature of the political forces that dominate the polity.

2.1 Informal Institutions: What Are They?

Informal institutions have been defined by [8,21,22] as a behavioral regularity based on socially-shared rules, usually unwritten, that are created, communicated, and enforced outside of officially-sanctioned channels. Unlike formal rules which are enforced by official entities, such as bureaucrats, police, judges, courts, etc., informal institutions are largely self-enforcing through mechanisms of responsibility, such as in patron-client or fiduciary relationships or community networks, or simply because following the rules is in the best interests of individuals who may find themselves in a 'Nash equilibrium' where everyone is better off from cooperation. While informal rules are generally not codified, it is normally widely accepted as legitimate and are therefore 'rules in operation' (in use) rather than just rules on the books, or what Ostrom terms 'rules in force' [8,23]. Informal rules are:

- socially sanctioned norms of behavior (attitudes, customs, taboos, conventions, and traditions);
- enforcement characteristics, self-enforcement mechanisms of obligation, expectations of reciprocity, internalized norm adherence (standard operating procedures), gossip, shunning, ostracism, boycotting, shaming, threats and the use of violence;
- extensions, elaborations, and modifications of formal rules outside the official framework; [8].

They express themselves in socially desirable or repulsive attitudes. They could be conceptualized as the informal social capital stock or liability of a people which builds and binds or bastardizes the social fabric. Amongst them are love, empathy, trust, fairness, forgiveness, selflessness, co-operation, community spirit, unity, patriotism, altruism, perseverance, accommodation and tolerance, solidarity, enterprise, etc. The very opposite of these concepts furnish examples of the undesirable expressions of informal institutions. These include greed, mischief, individualistic spirit, divisiveness, vengeance, intolerance, avarice, impatience, dishonesty, hate, etc. Consequently, the greater the fossilization of these undesirable informal institutions within the greater segments of the population, the greater the manifest inefficiency of any formal institutional rules or mechanisms superimposed on the society.

In Bangladesh for instance, it is this informal institutional approach to banking that earned Muhammad Yunus the Nobel Peace Prize in 2006. Grameen Bank founded by Professor Yunus on the principles of trust and solidarity, has so far established 2,567 branches, with a total of 12,500 staff in the service of 2.1 million borrowers in 81,388 villages. The bank rakes in a daily average of $1.5 million in weekly installments. Of the borrowers, 94% are women and over 97% of the loans are redeemed, a recovery rate higher than any other banking system [24]. This informal code of conduct is also the brain behind the enterprise and industry of the Igbos in Eastern Nigeria. It is this informal social capital amongst them which makes the Igbo patient and perseverant in service to his master in the hope that one day (seven years in most cases) he will be a master too. No official decree or legislation can internalize such ennobling virtue in a people; it is an evolution intricately woven in the womb of the values and culture of a people. Informal institutions also explain why some tribal groups are more inclined to doing a particular business – the Hausa-Fulani to cattle rearing, the Asho-Oke textiles dominated by the Yorubas of Western Nigeria, the Igbos in the spare parts business, etc.

[25] affirms the socio-economic relevance of Self Help Groups (SHGs) in the amelioration of poverty and long term economic development of Cross River State of Nigeria. These are generally nonprofessional organizations of about 10 to 20 persons, who mobilise financial resources, extend marginal interest bearing loans to their members, and help each other to deal with the 'common problem'. But it must be noted that the basis upon which SHGs exist and thrive is that kindred spirit of trust, solidarity and unity – informal institutions at work in the sphere of business and economics.

On a negative note, it is the impatience of most Nigerians, the culture of intolerance, our selfishness on highways that results in traffic grid-lock on our roads. This spirit of intolerance even breeds a cycle of exploitation: passengers are often shocked when their driver attempts to produce his papers to the police. They are impatient, preferring the driver to bribe his way than to “waste their time” in tendering his particulars and allowing the police to do their legitimate duties. Thus it is that the police take advantage of this attitude. Currently, a culture of quick prosperity has gripped most of our young people. Hard work is no longer a virtue; an average Nigerian student feels it is useless to cultivate the habit of discipline in studies; he believes he can never pass exams on merit, and therefore must look for extraneous means to get through. The rise of ethnic nationalism has further compromised national patriotism. An average Nigerian sees himself first along tribal leanings before he thinks along national character. Our national ethos and ideology have been lost to ethnic solidarity and clannish cleavages. So there exist different, and often, opposing allegiances which negates the principles of the Nigerian Project. Bail is free, so the law says. But hardly does an average Nigerian challenge monetary payments upon his arrest or that of his relation. And it is equally doubtful if such challenge would yield any fruit. An ingrained ideology exists amongst most Nigerians that the moment one has a case with the police, one has to part with money whether one is at fault or not. These are all variants of informal institutions. In effect, governments must appreciate the delicate link between these classifications of institutions in order to initiate congenial policies that would bring about effective and salutary development outcomes.

In the literature two strands of proposition can be deciphered–1) that which allocates a significant place for institutions as determining economic growth and 2) those who, though agreeing to the primacy of institutions in influencing economic outcomes, nonetheless decry the conceptual methodology adopted in measuring institutions.

[26] for instance, contend that the major factors which account for differences in growth across countries are simply divergence in economic institutions. Thus the problem of development can only be solved if institutions in developing countries are reformed. They however admit that the process of reforming institutions is a difficult one since “economic institutions are collective choices that are the outcome of a political process”. Indeed it is the nature of political institutions and the distribution and devolution of political power that gives vent to institutions. The factors that lead a society into a political equilibrium which supports good economic institutions are still scanty in the literature. Other studies in this category include [27-31].

[32,33] are all of the opinion that a considerable proportion of the differences between developed and developing countries can be attributed to the quality of shared rules or institutions which coordinate individuals. Some societies stick to rules which engender trust, self-reliance and incentives to perform, while others are imbued with widespread restraints on economic freedom and are consequently backward. [34] advocate a place for property rights for economies undergoing macroeconomic reforms.

However, for [35] their analysis as to whether political institutions impact growth or whether growth and human capital accumulation lead to institutional efficiency reveal that most indicators of institutional quality used to establish the link between institutions and growth are conceptually deficient, nor are the instrumental variable techniques employed in the literature any better. Their study suggest that a) human capital is a more basic source of growth than are the institutions, b) poor countries get out of poverty through good policies, often pursued by dictators, and c) subsequently improve their political institutions.

[36] seem to share the sentiments of [35] where, according to them institutions are highly persistent, shaped mostly by history, including colonial history, politics, and that institutional outcomes get better as the society grows richer. In the [36] model, institutions exert a second order effect on economic performance, the first order effect coming from human and social capital which shape both institutional and productive capacities of a society.

3. ARE FORMAL INSTITUTIONS SUFFICIENT CONDITIONS FOR ECONOMIC DEVELOPMENT?

The literature reviewed above documents strong evidence of correlation between a broad spectrum of formal institutions (government policies, legislations, etc.) and economic growth. Thus broad institutional differences across countries have had a major influence on their economic development. From hindsight, after the World War II, East and West Germany was separated by the notorious Berlin Wall, with the East administered along communist principles of Russia and the West by capitalist ideologies. In the former, a command type of economy which had no respect for property rights prevailed while in the latter, capitalist principles held sway with the Marshal Plan having a significant effect on

West Germany's growth path. After decades, profound differences were noticed between the economies of the East and West. The same goes for North and South Korea. With the North preferring a Socialist model (command economy, zero tolerance for private property, absence of legal protection) against the South's capitalist leanings, the economies of the two Koreas diverged with the South gaining ascendancy in economic growth. These examples portray the effect of formal institutions on institutional and development outcomes. Again, [36] found that, while the total cost of opening a medium-size business in the United States was below 0.02% of GDP per capita in 1999, the same cost was 2.7 percent of GDP per capita in Nigeria, 1.16% in Kenya, 0.91% in Ecuador, and 4.95% in the Dominican Republic. These entry barriers are highly correlated with various economic outcomes, including the rate of economic growth and the level of development. Variations in educational institutions also have corresponding differences in human capital which invariably influence economic performance of countries.

Very significantly, the incentives provided by the deregulation of the telecommunications industry in Nigeria in the early part of the last decade heralded an explosive growth in that sector. Today tens of thousands of jobs have been created as a result of that singular policy. Conversely, the power and energy sectors of the economy have either witnessed decline or stagnation because of lack of enabling legislations to guarantee the protection of private investments. Delay of the National Assembly to pass the Petroleum Industry Bill has stalled further investment by the oil companies in the Nigerian petroleum sector, because investors desire a clear knowledge of the cost and returns on their investments. With the deregulation of tertiary education, huge private sector investments have flowed in that direction, with attendant impact on human capital quality and jobs creation. Formal institutions indeed broadly determine economic outcomes.

However, we also note that empirical evidence on the net effect of national formal institutions and policies in Northern Nigeria, for instance, suggest a systematic divergence from the rest of the country. The disparity can be attributed to the influence of informal institutions acting contemporaneously with the formal institutions. For instance, of the 100 million Nigerians living in absolute poverty, those who can't afford the basics of food, shelter and clothing—the majority reside in the Northern states. The North-West has the highest poverty rate with 70 per cent of its people living below $1 per day. The North-East follows with 69 per cent and the North-Central with 59.5 per cent [37]. According to [38], in 2011 Northern Nigeria had the largest number of children in the world that did not go to school. And between 1950 and 1956, the region had only 10 university graduates while the South-East had 877 and the South-West over 2,000 [39]. Still, the National Bureau of Statistics documents Sokoto and Bauchi as having a literacy rate of 33.1% and 39.5% respectively, while female literacy in Sokoto, Kebbi, Zamfara, Jigawa, Katsina, Bauchi and Niger is below 20%, compared to 81% and above in Ekiti, Imo, Anambra, Ogun and Lagos in the South [39].

This gloomy picture is also painted in the general unemployment level where unemployment is higher in the Northern states than the national average of 23.9%, with Zamfara having 42.6%, Bauchi 41.4%, and Niger 39.4%. In the health sector, immunisation had only 3.7% coverage in 2008 in the North-West; 3.6% in the North-East; compared to 44.6% in the South-East. Immunisation rates in Northern Nigeria are some of the lowest in the world. According to the 2003 National Immunization Schedule the percentage of fully immunized infants on the States to be targeted was less than 1% in Jigawa, 1.5% in Yobe, 1.6% in Zamfara and 8.3% in Katsina. As a result thousands of children are dying as victims of vaccine preventable diseases; others suffer from lifelong paralysis.

Indeed, these statistics are significant in locating the relevance of both formal and informal institutions in altering the aggregate level of national development. Why is it that in the same country where policies are made for the overall national development, policies produce different and divergent results? The answers lie in the fact that formal institutions find their effective expressions in the underlying core of a people's informal values, norms, culture and religion. The more fossilized these substructures are, the greater the constraint on progressive approaches aimed at national development, the greater the manifest inefficiencies of any formal mechanisms. Whether in northern or southern Nigeria, the fixated mindsets of the people and the incentive structures that govern their behavior largely determine the effectiveness of formal rules of engagements and economic transactions. Indeed, the above empirical data affirms that formal institutions alone do not guarantee salutary development outcomes; they are a necessary but not a sufficient condition for growth and development.

Nor have the South fared better when evaluated against other economic and social parameters. It is an arguable perception that the social and cultural sentiments in the North savourmore honesty, unity, and selflessness as against the Southern society. These unwritten codes, when brought into the business and economic spheres, are sure to produce better development outcomes than it would in the South. An average indigenous northerner may sell his goods to you on credit with the trust that you shall pay, even without knowing you. This hardly happens in the South. This also explains why the concept of non-interest banking finds more acceptability there.

Policies on education and health in the Northern Nigeria produce different outcomes because of the entrenched value system coupled with the cynical manipulation of belief systems to emasculate the people. When it is believed by a huge segment of the population that polio vaccination reduces human fertility, then the needed co-operation from the citizens would be lost no matter the preachments. When the girl child is still subjected to all forms of inhuman treatment by reason of her gender, even with the passing into law of the Child Rights Act, then the national education policy would be less effective. Yes, the noticeable difference in the development paths of both Northern and Southern Nigeria, discounting any fiscal allocation issues, can be explained by differences in informal institutions already entrenched in the regions. In other words, the efficiency of formal institutions is constrained by the overwhelming presence of the informal; it is a binding constraint that must be relaxed for optimal efficiency of formal institutions.

4. INSTITUTIONAL EFFICIENCY

Property and contract rights are the basic components of economic institutions. They manage and organise all economic interactions in production, exchange and distribution. Property rights emanate from property law, whereas contract rights are defined by contract law and by institutional arrangements of economic agents. They are laws created by the State on how individuals can control, benefit from and transfer property. A property right is the exclusive authority to determine how a resource is used, rights to the services of a resource, and rights to exchange the resource at mutually agreeable terms. Thus, individuals and organizations create contract rights on the one hand, while the state specifies them through contract law on the other. The state also creates property rights through property law, thus becoming responsible for the enforcement of all economic institutions [40].

Thus a set of economic institutions is "efficient if the state has no feasible alternative to create and enforce property and contract rights which everyone finds at least as good and which at least one of the economic actors strictly prefers" [40]. Thus institutional efficiency is cast within the context of pareto optimality. Embedded in this definition is the assumption that the process of creating and enforcing property and contract rights naturally produces transaction cost. Thus a condition of optimality or efficiency is reached where these costs are reduced to their barest minimum so that the State does not have any credible option to the prevailing environment where some agents (at least one) finds preferable. Institutions are efficient if they reduce transaction costs.

First, it must be emphasized that self-serving tendencies of economic agents in the market can never produce efficient institutions. This assumption justifies the involvement of the State in correcting distortions and playing an active role in the economic arena. It also underscores why the State must drive the process of achieving efficiency of institutions in its jurisdiction. However, for it to do this the State must possess the *capacity* to create and change relevant institutions; it must also possess the *commitment* to enforce the rules it has created. This crucial role accorded the State is not novel to institutional economics–recall the advocacy of Keynesianism for the State via the use of fiscal policy. This is predicated on three considerations: firstly, the State has legal jurisdiction over its territory; secondly, its monopoly on the use of force ensures that conflicting claims to property rights can be resolved and thirdly, they have inherent power to negotiate and cooperate amongst each other, thus reducing transaction costs and co-ordination problems.

The Nigerian State, by virtue of the political notion of sovereignty by which it is independent, can aptly be described as having the capacity to create, change and enforce the rules that will influence economic behaviour. But it is doubtful if it has the requisite commitment to enforce the rules it has created. It must be borne in mind that both requirements of capacity and commitment are a function of the quality of the human components and players wielding the levers of State power structure. The probes of the Fuel Subsidy, Power Sector, Aviation, etc. provide us doubtful credentials of the commitment of Nigeria's political institutions to produce efficient market outcomes. In 1983 however, during the heydays of military rule, the Burhari-Idiagbon junta furnished a classic example of how the State can alter the both the formal and informal institutions and attitudes of the people to acceptable ends. The War against Indiscipline (WAI) was a national slogan whose efficacy in modifying the near bestial ways of Nigerians was almost ubiquitous. Discounting the obvious flaws of their approach however, that era is an apt instance of a government that had both the capacity and commitment necessary to guaranteeing efficient institutions. Thus, economic institutions are the outcomes of the political process.

It is thus not surprising, judging from Table 2, the high correlation between Nigeria's economic performance measured by per capita GDP and other institutional indicators. Apart from rule of law which reflected a negative correlation with percapita GDP, all others turned in a positive relationship with growth.

5. THE DYNAMIC INTERACTIONS BETWEEN FORMAL AND INFORMAL INSTITUTIONS

In this section we extend the argument to consider the mechanisms of interactions and links between formal and informal institutions. Put differently, we inquire as to the means by which formal institutions such as constitutions, laws, property rights, charters, bylaws, statute and common law and regulations, as well as their enforcement characteristics–official sanctions, such as criminal punishment, fines, incarceration etc. interplay to produce sets of outcomes, sometimes different from expectations. [8,21] have documented four schematic ways in which informal institutions interact with the formal. These are:

1. Complementary
2. Accommodating
3. Competing
4. Substituting

From Table 3, two outcomes are possible given the interaction between informal and formal institutions: they can either converge or diverge. When the former happens, it means informal institutions have complemented with the formal and the latter is effective in ensuring desired policy outcomes. Suppose a legislation outlawing homosexual relations is passed by the National Assembly. Such laws would indeed be effective because the ingrained norm and social values of most Nigerians frown against same-sex marriage and so the enforcement authorities would have no difficulty enforcing the law. In fact the religious and cultural sentiments of the people would work in tandem with the police in apprehending anyone who violates the law. Again, let's suppose the law against exam malpractice was passed against the historical background of a people who cherished hard work and decried dishonesty. Or yet in another case, there was a legislation compelling individuals to form cooperative societies in order to access loans from the government. In the two examples, the formal would complement the informal and create a convergence if there existed a congenial spirit amongst the people consistent with the formal rules just established.

Table 2. Correlation between Institutions and Economic Performance[1]

	PGDP[1]	GOVTEFF[2]	RLAW[3]	CIM[4]	CORPT[5]
PGDP	1.00000				
GOVTEFF	0.504231	1.00000			
RLAW	-0.453536	-0.841987	1.00000		
CIM	0.683020	0.424081	-0.281481	1.00000	
CORPT	0.278833	0.069957	0.042157	0.069750	1.00000

Source: By Authors; 1) GDP per capita (2) Government Effectiveness. 3) Rule of Law 4) Contract intensive money. 4) Corruption

Table 3. Typology of Informal Institutions

Outcomes	Effective Formal Institutions	Ineffective informal Institutions
Convergent	Complementary	Competing
Divergent	Accommodating	Substituting

Adapted from: Soysa and Jütting [8]

In the second scenario, divergence becomes the outcome when the informal accommodates the formal, and the latter is judged effective only as it violates the spirit of the law but upholds the letter. In Nigeria, there exist the Public Procurement Act, 2007 whose core objectives are accountability and transparency in the procurement process; the establishment of pricing standards and benchmarks; ensuring the application of fair, competitive, transparent, value-for money, standards and practices for the procurement and disposal of public assets and services. The general perception is that this law is observed in the breach as the Executive arm of government mostly informally determines beforehand who to give a contract. And when the deal is struck, it subsequently formalizes the process by calling for bids from the public in line with the letter of the Act. Argument in favour of this approach is that it ensures effectiveness in projects execution and wards off delay. Cogent examples like the return of unused budgetary allocations to Ministries, Departments and Agencies, after a fiscal year has elapsed, are given to justify the breaking of the spirit of the law.

Thirdly, a divergence again becomes the outcome when informal and formal institutions compete with themselves with the latter becoming ineffective because the laws are poorly enforced or not enforced at all. For instance, our traffic laws prescribe every motorist to put on seatbelt for safety purposes. But in many Nigerian cities, this piece of legislation is brazenly ignored by the authorities because the cost of enforcement far outweighs the short term gains from it. And so in the long term, the nonchalant attitude of the citizenry effectively competes with the formal law, driving it almost to extinction or at best to redundancy. The Child Rights Act suffers from the same competitive effect. Children are still abused, trafficked, and labeled as witches. The cost of enforcement, it seems, outweighs the gains; and so the authorities are content to allowing the legislation dead on paper.

A fourth and final scenario results when the informal substitutes the formal because of the ineffectiveness of the latter. The informal exists because they pose no threat to the formal which in itself is not fulfilling its full objectives. This is true of the Nigerian financial space, where SHGs mentioned above exploit the vacuum and inefficiencies created by the conventional banking system. A general notion is that banks waste so much time in attending to their customers, and that one must have substantial amounts to do business with them. But SHGs wouldn’t mind visiting their clients in the markets, stores, homes, etc. to collect marginal savings of as low as one hundred naira. This explains the existence of a large underground economy in Nigeria. Some traders prefer to keep their huge balances underneath their stores than in banks, and this has negative implications for monetary policy.

Fig. 2 shows a simple schematic model of the interaction between formal and informal institutions, suggesting that both matter for development outcomes and therefore, for policy.

Our outline so far suggests that policy makers must understand these intricate chains of interactions to determine the effect of a specific formal rule on institutional outcomes which in turn affects developmental outcomes. For instance, we recall that the Indirect Rule System of governance introduced by Lord Lugard in 1914 was hugely successful in the North of Nigeria as compared to the South because in the former there were underlying informal institutional structures that aided and moderated positively the Indirect Rule System. The South in contrast to the North had lower “levels of preexisting social capital” shaped by a culture of republicanism and liberal religious norms. In other words informal institutional structures of hegemony were absent, and so the policy suffered some setbacks as against a conservative religious ideology and a monarchical traditional structure of the North. Thus in the words of [8], “government effectiveness is enhanced where there is a high level of civic engagement because the mass of people will be better consumers of politics, more attentive clients of bureaucrats, and cooperate more easily among each other to solve collective dilemmas.”

6. FORMAL AND INFORMAL INSTITUTIONS: ISSUES OF POLICY OPTIMALITY

This section evaluates the salient questions of the optimal policy mix between formal and informal institutions. In other words, between the two, which should occupy the attention of policy makers? An answer to this question is by no means straightforward, and can to a large extent be located within the context of our previous analysis.

It has been shown that ultimate development outcomes (poverty reduction, growth and development) are dependent upon institutional outcomes based on a complex web of interactions linking a specific institution (and the sum-total of its players within that framework), whether formal or informal, to a particular intended government policy. Take education for instance, formal rules or policy around the sector would only influence national development through the quality of human capital produced, which is dependent on the informal codes of conduct, the values, the binding norms, attitudes, beliefs, culture, etc. of Nigerians regarding such policy. Thus the priority of government in the specific instance should reflect the underlying mischief created by the informal institutions and not only concentrating on the external dimensions of policy. In the North of the country, for instance, why should state governments burden their priority to the provision of tertiary education through the establishment of state universities where the region's quota in the existing federal universities and even unity schools are far from being filled? Their focus should be on primary and secondary education where current research [41] reveals that the North-west geo-political zone accounts for 70% of the nine million almajiris in the country, who mostly depend on street begging to survive. Or the stark reality of admitting a student from the north with 2 marks into federal government colleges while his counterpart in the South would require 139 marks. Even at that, current formal policies introduced by the government to curb the menace would not also yield the desired result if painstaking efforts are not initiated in research to reveal the fundamental cause of the almajiri phenomenon itself, because the latter is an external manifestation of something more basic. Now, this calls for great caution!

Corruption thrives, not because of the dearth of formal institutions to address it; but the informal institutional dynamics of the citizenry predominates and thus crowds out or out-competes the formal institutions. What should be done? What are the policy options? We must look at the incentive paradigms. Does it pay a policeman better to "settle" with a law-breaker than to go through the whole hub of the judicial process? The latter option will no doubt benefit the State and society, whereas the former will bring immediate personal gain to the policeman. Now, his choices will depend on the incentives before him. Does the system reward him enough for being patriotic, or does someone else get the credit for his efforts? Will the system in the end allow the culprit go scot-free to his chagrin, and therefore makes him look foolish for doing his duties? Is his future secured within the workplace and social system? Are there safety nets (education for his kids, healthcare, retirement benefits, etc.) for him and his family to compensate for the risk he takes in the interests of the State? Does his nominal income guarantee him the bare basics of existence? The considerations are endless! In the end, his actions will weigh heavily in favour of those considerations that maximize his present utility. In effect, government policy of human-centred development is capable of altering the balance of perception and incentives in favour of personal ownership and commitment to duties. His job would no longer be seen as the Government's, but his.

In other words, it does appear that in some instances the issue of inter-temporal choice is at the core of institutional efficiency and the fight against corruption in Nigeria. Citizens at all levels weigh current decisions against the options available for them in future. Conceptually, institutions facilitate economic development by reducing the costs of doing business (transaction costs) and ensuring competitive processes [8,42) but where economic agents find informal institutions better tools in enhancing their preferences for costs reductions and competitiveness, then they would gladly go for it. Thus fuel, for instance, must be hoarded because one does not know when the next scarcity will come; bribes are given and received because the process of litigation is cumbersome and lengthy; the public service is corrupt because of deliberate red tape to warp and distort the system; education system is inefficient because teachers feel the reward system is skewed against them. Why is politics a do or die affair? Because of the fear of the unknown, the opportunity may not come again! Thus, the dilemma in reforming institutions or specifying policy priorities or preference between informal and formal institutions is that it is not purely and economic problem. Legislations are elitist in character with rare considerations for the average Nigerian. With such warped mindset, the Nigerian does not see himself as part of the State but as an alien, and so adopts a hostile uncooperative psychological disposition to State policies and institutions. Issues of institutions are not determined by economists but by politicians and other players who have other preferences other than immediate national development as their goal.

In a word, the question of optimality between formal and informal institutions bothers on pragmatism, one which focuses and takes advantage of the settings, the context, and the dynamics of interacting forces of economics, politics and the social engineering of the people to achieve holistic development outcomes. Where for instance, informal institutions predominates and crowds out the effectiveness of formal institutions, policy should be geared towards the informal with the aim of altering the balance of effect to produce desired outcomes. Where a specific stock of positive informal capital already exists, then formal mechanisms should gain priority.

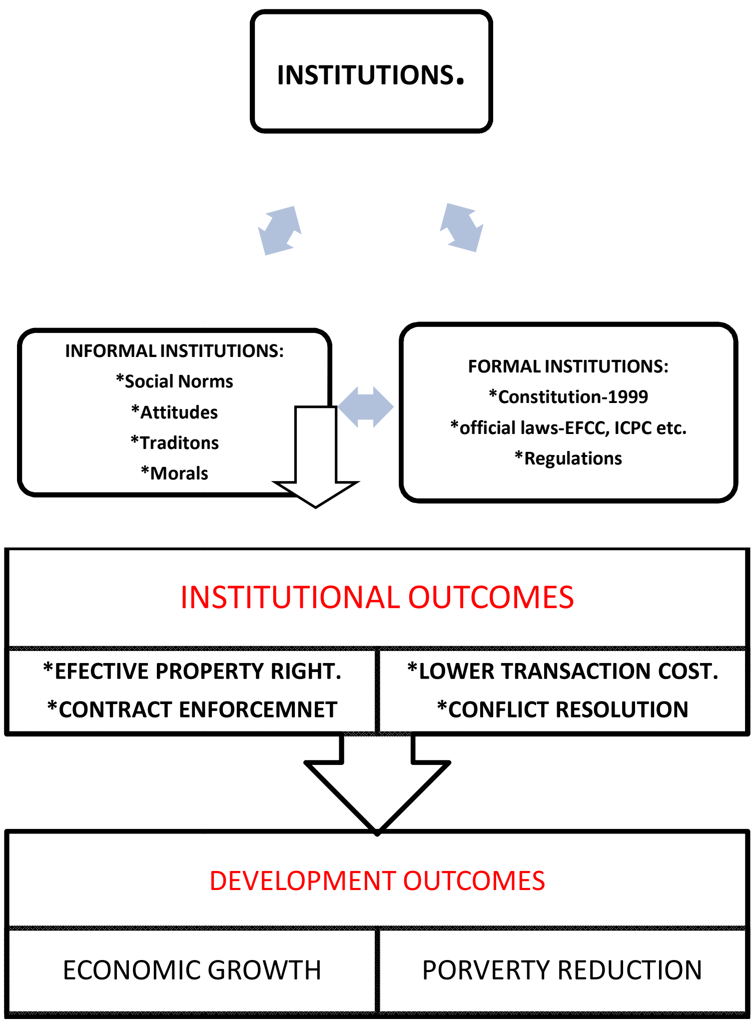

Fig. 2. Interaction between Formal/Informal Institutions
Source: Authors – based on literature review

7. CONCLUSION

A brief conclusion is here proposed. Several questions begged for answers in this paper: why are our formal institutions and enforcement mechanisms not effective? Is there any connection between formal and informal institution? Which sustains the other? Is it the formal that guarantees the sustenance and durability of the informal or otherwise, or are they mutually re-enforcing paradigms? Which of these divides should capture the attention of policy makers and stakeholders of the Nigerian Project–formal or informal institutions, or both?

Our findings indicate that 1) formal institutions are not effective because the overwhelming preponderance of informal institutions, entrenched and percolating through the fabric of culture, religion, norms, attitudes, etc. effectively crowd out the efficiency of its formal counterpart. For instance, a recent move by the Federal Government in securing external loans from China fragrantly violates both the letter and spirit of the Fiscal Responsibility Act, 2007 which provides at Section 44 (1) (2) conditions precedent for borrowing. But the legislature looks on because the “Nigerian factor” (a nebulous idiom for myriads of perversions) holds sway. 2) There is a complex web of interactions that govern the two taxonomies of institutions–i.e. they are mutually reinforcing paradigms, coalescing into warped institutional structure over decades of exchanges at the various micro levels of community, clans and ethnic domains–so that policy makers risk misfiring without adequate knowledge of these relationships. Indeed both matter as long as policy intervention is concerned and the context, location and space of intervention determine the policy preference to be deployed, i.e. whether a particular issue requires more of formal policy leverage or more of the informal, or a delicate balance and deployment of both is a matter of pragmatism and empiricism. 3) Institutions are collective choices which are a consequence of the nature of political forces operating within a society. Where a political disequilibrium exist and is entrenched, as it does in Nigeria, there would certainly arise a corresponding inefficiency and distortion in both formal and institutional mechanisms.

In effect, informal institutions are binding constraints on informal institutional efficiency in Nigeria. These constraints must be relaxed through plurality of approaches, details of which are beyond the objectives of this paper. In proffering a terse recommendation however, we suggest that the starting point is to obtain a *better* understanding of the sources of these informal constraints and why they persist. The State therefore stands in a vantage position in altering the dynamics in favour of better institutional outcomes since it has both the legal mandate and the instrument of coercion. Clearly, the Nigerian State has the capacity to do this, but regrettably possesses no commitment, which is a function of the political process that produced the human players managing the ship of state. Thus, focus must be on the how to secure a durable political economic equilibrium that will dictate better institutional outcomes.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

REFERENCES

1. Ajayi SI. “Institutions, The Missing Link in the Growth Process”, NES Presidential Address Delivered at the 43rd Annual Conference of NES held in Lagos 7-8th August 2002; 2003.
2. North Douglass C. The Role of Institutions in Economic Development. UNEC for Europe, Geneva, Switzerland; 2003.
3. North Douglass C. Understanding the Process of Economic Change. Princeton, NJ: Princeton University Press; 2005.
4. Sanusi LS. “Banking Reforms and Economic Development in Nigeria”, being Paper Presented at a Retreat for Members of the Revenue Mobilization Allocation and Fiscal Commission on Thursday, 17th February, 2011 at Le Meridien Hotel, Uyo, Akwa Ibom State; 2011.
5. World Bank, World Development Report. Washington DC: World Bank; 1991.
6. David Paul. Rethinking Technology Transfers: Incentives, Institutions, and Knowledge-Based Industrial Development. In Charles Feinstein and Christopher Howe, eds, Chinese Technology Transfer in the 1990s: Current Experience, Historical Problems, and International Perspectives. Cheltenham UK: Edward Elgar; 1997.
7. Aron J. Growth and Institutions: A review of Evidence. The world Bank Research Observer 2000;15:99-135.

8. Soysa Indra De, Jütting Johannes. Informal Institutions and Development: Think Local, Act Global? International Seminar on Informal Institutions and Development– What do we know and what can we do? OECD Development Centre and Development Assistance Committee–Network on Governance; 2006.
9. DiMaggio Paul. "Culture and Economy". In The Handbook of Economic Sociology, ed. Smelser NJ, Swedberg R, Princeton NJ. New York: Princeton University Press & Russell Sage Foundation; 1994.
10. Helliwell John F. "Economic Growth and Social Capital in Asia". NBER Working Paper 5470. National Bureau of Economic Research, Cambridge, Mass. Processed; 1994.
11. Helliwell John F. Do Borders Matter for Social Capital? Economic Growth and Civic Culture in U.S. States and Canadian Provinces. NBER Working Paper 5863. National Bureau of Economic Research, Cambridge, Mass. Processed; 1996.
12. Mauro Paolo. "Corruption and Growth," Quarterly Journal of Economics, 1995;110:681-712.
13. Effiom Lionel. "Institutional Frameworks, the Transformation Process and the Challenge of Coordination", in 'Planning and the Transformation of the Nigerian Economy', selected Papers for the 2011 Annual Conference of the Nigerian Economics Society; 2011.
14. Przerworski Adam. Geographyvs. Institutions Revisited: Were Fortunes Reversed? Mimeo, New York University; 2004b.
15. Przeworski Adam. The Last Instance: Are Institutions the Primary Cause of Economic Development? Mimeo, New York University; 2004a.
16. Kormendi Roger C, Philip G Meguire. Macroeconomic Determinants of Growth: Cross-Country Evidence. Journal of Monetary Economics. 1985;16(2):141–63.
17. Scully Gerald W. The Institutional Framework and Economic Development. Journal of Political Economy. 1988;96(3):652–62.
18. Clague Christopher, Keefer Philip, Knack Stephen, Olson Mancur. "Contract Intensive Money" MPRA Paper No. 25717, World Bank, Washington DC; 2010.
19. Kaufmann D, Kraay A, Mastruzzi M. "The Worldwide Governance Indicators: A Summary of Methodology, Data and Analytical Issues". World Bank Policy Research Working Paper No. 5430; 2010.
20. The World Wide Governance Indicators; 2013.
21. Helmke Gretchen, Steven Levitsky. Informal Institutions and Comparative Politics: A Research Agenda. South Bend, IN: Kellogg Institute for International Studies, Notre Dame University; 2003.
22. Pejovich Svetozar. The Effect of the Interaction of Formal and Informal Institutions on Social Stability and Economic Development. Markets and Morality. 1999;2(2):164–81.
23. Ostrom Elinor. "Understanding Institutional Diversity". Princeton NJ: Princeton University Press; 2005.
24. Available:http://www.grameen-info.org/index. 2013;404.
25. Essia U, Mba PN, Ebokpo M, Ekpo N, Obaji A. Self Help Groups in Cross River State, Nigeria. European Journal of Social Sciences. 2013;39(2).
26. Acemoglu Daron, Robinson James. The Role of Institutions in Growth and Development. Working Paper No. 10, The International Bank for Reconstruction and Development / The World Bank; 2008.
27. Knack S, Keefer P. Institutions and economic performance: Cross-country tests using alternative institutional measures. Economics and Politics. 1995;7(3):207–227.
28. Kaufmann Daniel, Kraay A, Pablo Z. Governance Matters II. World Bank Policy Research Working Paper 2772. Washington, DC: World Bank; 2002.
29. Chong A, Calderon C. Causality and Feedback between Institutional Measures and Economic Growth, Economics and Politics. 2000;12(1):69-81.
30. Rodrik D, Subramanian A, Trebbi F. Institutions rule: The primacy of institutions over geography and integration in economic develop; 2002.
31. Dollar D, Kraay A. Institutions, trade and growth. Journal of Monetary Economics. 2003;50:133-162.
32. Gwartney James, Lawson Robert. The concept and measurement of economic freedom. European Journal of Political Economy. (2003;19:405–430.
33. Driscoll O, Gerald P, Grady O, Mary Anastasia. "Index of Economic Freedom". Washington: The Heritage Foundation and Dow Jones; 2003.

34. Addison Tony, Mina Baliamoune-lutze. Industrial Quality, Reforms and Integration in the Maghreb, UNU/WIDER Discussion. 2003;76.
35. Glaeser EL, Porta RL, Florencio Lopez-de-Silanes, Shleifer A. Do Institutions Cause Growth? Bristish Journal of Political Science. 2004;27(3):453-72.
36. Djankov Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer. The Regulation of Entry. Quarterly Journal of Economics. 2002;117:1–37.
37. National Bureau of Statistics. Statistical News: Labor Force Statistics No. 476. Abuja: The NBS Publication; 2010.
38. World Bank, World Development Report. Washington DC: World Bank; 2012.
39. The Punch Newspaper, February 19; 2012.
40. Borner S, Bodmer F, Kobler M, Institutional Efficiency and its Determinants: The Role of Political Factors in Economic Growth, An OECD Publication; 2004.
41. Okene Adam. CKN Nigeria of Tuesday, 15 January 2013 05:06 Available: http://www.cknnigeria.com Website accessed on 11/08/2013.
42. Islam Roumeen. The Institutional Foundations of a Market Economy: What Makes Markets Work Well?" In The Institutional Foundations of a Market Economy, ed. Kochendörfer-Lucius G, Pleskovic B. Berlin: German Foundation for International Development (DSE); 2001.

Peer-review history:
The peer review history for this paper can be accessed here:
http://www.sciencedomain.org/review-history.php?iid=701&id=20&aid=6493