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Institutional Factors and Its Effect on Economic Growth of Nigeria

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ABSTRACT

This study looked into how institutional factors have influenced economic growth in Nigeria. Annual time series data from 1996 to 2023 were utilized for the study. To guide the study, pertinent questions were asked such as how has institutional factors affected economic growth in Nigeria? This investigation employed the Ordinary Least Square model in the estimations in order to achieve its stated objectives. The results revealed that institutional factors are dysfunctional and weak in promoting economic growth in Nigeria. In line with the findings, the study therefore recommends that Rule of law should be strengthened in the country. The result shows that rule of law is significant in deteriorating economic growth in Nigeria. The political elites and the rich should not bend the arm of law. This will help the workability of institutional framework in restoring the country to the path of sustainable growth.

Keywords: Institutional factors; Economic growth; Rule of law; Institutional quality; Governance; Ordinary Least Squares (OLS); Nigeria.

INTRODUCTION

Nigeria's performance has been inconsistent despite a number of measures and reforms intended to promote economic growth. High unemployment, limited industrial output, inadequate infrastructure, and an excessive reliance on oil are still problems facing the economy. Many of these issues stem from institutional flaws, which show themselves as ineffective policy execution, weak property rights, bad governance, and a lack of accountability. In the Nigerian context, institutional determinants of growth have gotten less empirical attention than economic ones like labor productivity and capital accumulation. In order to provide evidence-based insights for policy change and national development, this study tackled the crucial subject of how institutional elements affect Nigeria's economic growth.

Economic growth, which reflects an economy's ability to raise the welfare and standard of life of its citizens, continues to be one of the most significant markers of a country's development. Since gaining independence, Nigeria, the most populous and economically significant nation in Africa, has seen a variety of growth trends. Although there have occasionally been times of fast expansion, especially during oil booms, these have frequently been followed by stagnation or collapse because of institutional and structural flaws. Economic outcomes are significantly influenced by institutional issues, including the quality of governance, the rule of law, political stability, corruption prevention, the efficacy of regulations, and government accountability. Incentives, transaction costs, investment choices, and the effective distribution of resources are all influenced by institutions, which serve as the framework for economic activity. While weak institutions encourage corruption, inconsistent policies, and poor use of public resources, strong institutions stimulate innovation, entrepreneurship, and sustainable economic progress.

Nigeria has a wealth of natural and human resources, but institutional inefficiencies seem to have limited economic growth. The efficacy of policies has been weakened by issues like political instability, corruption, inadequate regulatory frameworks, subpar bureaucracy performance, and disrespect for the rule of law. Over the years, a number

of reform attempts have been put in place to address these issues, including the Structural Adjustment Programme (SAP), privatization plans, and anti-corruption campaigns; nevertheless, their effectiveness has been constrained by the ongoing institutional deterioration.

Strong and inclusive institutions are associated with faster and more sustainable growth rates, according to empirical research by [1], [2], and [3]. In contrast, underdevelopment and economic instability are common in nations with weak and extractive institutions. An iconic illustration of how institutional quality may either support or impede economic advancement is provided by the Nigerian scenario.

Therefore, this study investigated the impact of institutional factors on Nigeria's economic growth, concentrating on how rule of law, corruption control, and regulatory quality affect the nation's growth trajectory.

Objectives of the Study

The main objective of this study is to examine the effect of institutional factors on the economic growth of Nigeria. The specific objectives are to:

1. Evaluate the impact of rule of law on economic growth in Nigeria.
2. Examine how regulatory quality affects Nigeria's economic performance.
3. Determine the influence of control of corruption on economic growth in Nigeria.

1. Literature

2.1 Conceptual Literature

[4], provided a definition of economic growth as the consistent and prolonged rise in a nation's actual income over an extended duration. Economic growth refers to a sustained increase in the value of a country's net national products, adjusted for inflation. According to [5], economic growth refers to the rise in the real value of goods and services generated by an economy, after accounting for inflation, as time progresses. Economic growth can be defined as the long-term expansion of the goods and services generated by an economy, usually at the national level.

The concept of economic growth has been defined differently based on the perception of various scholars. Earlier studies such as [6], defined economic growth as a gradual long-run change that increases savings and population. [7], argues that economic growth is a sustained increase in per capita national output or net national product over a long period which must be greater than the rate of population growth. As stated by [8], economic growth involves the quantitative increase in the monetary value of goods and services produced in an economy within a given year. It also represents an upsurge in the economy's capacity to produce goods and services for a specific period compared to another period [9]. Previous studies have captured economic growth using several measurements. For instance, [10], measure economic growth in monetary terms without considering other aspects of development. In the case of this study, economic growth is considered in its real terms and is measured with the real gross domestic product (RGDP). Real gross domestic product is the total value of goods and services produced in an economy in a specific period after adjusting for inflation. It shows the true growth of an economy over time.

Measures of Institutional Factors

Some of the most commonly used measures of institutional factors are, the governance indicators of the World Bank, The polity IV measures, Ibrahim Index of African Governance, and Bertelsmann Transformation Index (BTI). However this study focused on the Governance Indicators of the World Bank: The Worldwide Governance Indicators report on six broad dimensions of governance for over 200 countries over the period 1996-2023. There are two ways to report the aggregate indicators: an estimate, ranging from approximately -2.5 to 2.5, and a percentile rank terms from 0 to 100. Higher values correspond to better outcome.

2.2 Theoretical Literature

Endogenous Growth Theory

The endogenous growth theory, commonly referred to as the new growth theory, is a crucial element in developing development theory. Paul Romer formulated this idea in a groundbreaking publication on the modern rejuvenation of growth theory, which was published in the Journal of Political Economy in 1986. Additional proponents of this idea comprise [11], [12], [13], along with Harrod and Domer. This idea represents an extension and alteration of the conventional growth theory. It emerged in the mid-1980s as a response to the dissatisfaction of a group of growth theorists with the prevailing explanations provided by neoclassical theories, which assert that external forces influence long-term economic growth. Therefore, the new growth theories challenged the neoclassicists' views and provided a rationale for why long-term economic growth can vary between countries and why capital tends to move from poorer nations to wealthier ones, despite the lower capital ratio in the former. The theory also elucidates the variables that govern the unaccounted-for amount of GDP growth (Solow residual) and are externally dictated in the Solow Neoclassical growth equation [14].

Assuming a consistent marginal capital product at an overall level and the absence of diminishing returns to capital (including human and knowledge capital), a constant and externally determined savings rate, a production function that does not exhibit decreasing returns to scale, and the presence of external economies and productivity enhancements resulting from investments in human capital that counteract the inherent tendency for diminishing returns to scale. According to the endogenous growth theory, productivity enhancements are a result of increased

innovation and investment in human capital [15]. Put simply, the theorists contended that investing in human capital, knowledge, and innovation has a vital role in driving economic progress. They emphasised that these elements are primarily internal and not influenced by external pressures.

The theory posits that economic growth is driven by internal factors and argues that sustained increases in GDP are the outcome of beneficial external influences stemming from policy actions that foster innovation and the dissemination of knowledge.

Endogenous growth theory opposes this neoclassical perspective by outlining ways in which economic considerations might affect the long-term rate of economic growth and, consequently, the rate of technological advancement. It begins with the observation that innovations, which take the shape of new goods, procedures, and markets and are frequently the outcome of economic activity, are what lead to technological advancement. A higher rate of economic activity, for instance, might accelerate process innovation by providing firms with more production experience. Firms learn how to produce more effectively through experience. In addition, as profit-seeking companies fund a large portion of research and development, economic policies pertaining to trade, competition, education, taxes, and intellectual property can impact the rate of innovation by influencing the private costs and benefits associated with doing R&D [16].

The endogenous growth models are characterised by the assumptions of non-decreasing returns to the set of reproducible factors of production. According to this supposition, nations need not converge in per capita wealth even if they share the same tastes and technological capabilities, and those that save more will always expand faster. Endogenous growth model proponents argue that the Solow model is empirically inadequate to explain cross-country variations, and therefore offer their models as an alternative [17]. When it comes to the convergence of nations, endogenous growth models predict substantially differently from the Solow model. The steady-state level of income in endogenous growth models does not exist; disparities in per capita income between nations can last forever, even in the case where population growth and saving rates are equal [16].

2.3 Empirical Literature

[18], investigated the growth impact of the EU's Structural, Cohesion and Pre-accession Funds. We look at a large sample of 27 EU countries and the UK, over a period of 1989 and 2020, essentially covering the full history of these funds. We show that the growth effect of the funds is conditional on institutional quality: the funds contribute to economic growth only in countries with strong institutions: low corruption, strong rule of law, effective governments, and strong regulatory quality. The research have important messages for the expected economic impact of the Next Generation EU (NGEU) and the Recovery and Resilience Facility (RRF). On the one hand, our findings highlight the risk that countries with weaker institutions – that also receive more funds - may use such funds less efficiently or wisely. On the other hand, countries that receive more RRF funds are also expected to introduce more structural reforms, some of which have the potential to improve institutional quality and thereby improve the effectiveness of the RRF and EU funds in general.

[19], investigated the impact of institutional framework on economic growth from 1996 to 2022. Under the theoretical framework of the endogenous growth model, the dependent variable in this study was economic growth proxied by real gross domestic product while the independent variables of interest were gross fixed capital formation, labour force, research and development and the six indicators of institutional framework (voice and accountability, rule of law, regulatory quality, government effectiveness, control of corruption and political stability). The fully modified ordinary least square was used as the method of analysis and the results revealed that labour force, research and development and regulatory quality have a positive and significant impact on economic growth. Contrary, control of corruption, government effectiveness and gross fixed capital formation have a negative significant impact on economic growth. More so, voice and accountability and rule of law have an insignificant but positive and negative impact on economic growth respectively. Following these findings, this study concludes that institutional framework has a significant impact on economic growth and hence recommends that the federal government should implement extensive institutional reforms that cut across all the arms and levels of government, with emphasis on the autonomy of ministries, agencies, parastatals and commissions to exercise discretion effectively to enhance the implementation of anti-corruption measures, the rule of law and promote good governance practices which in all would foster sustainable economic growth.

[20], investigated the relationship between institutional factors and economic growth in Nigeria from 1996 to 2022. It aims to examine the direction of causality among measures of institutional factors and economic growth. The endogenous growth theory provided the theoretical framework for the study. Data were obtained from the World Bank Database. Economic growth was measured using gross domestic product per capita and institutional factors were measured by political stability, government effectiveness, rule of law, and corruption. The Toda-Yamamoto non-granger causality test was used to determine the direction of causality among measures of institutional factors and economic growth. There is unidirectional causality running from political stability to economic growth, government effectiveness to economic growth, and from the rule of law to economic growth. There is bidirectional causality between corruptions to economic growth. The results suggest that strengthening institutions, improving

governance, and promoting transparency are essential for unlocking Nigeria's economic potential. The study recommends judicial reforms, anti-corruption measures, and capacity building to foster a conducive environment for economic growth.

[21], examined the nexus between institutional quality and economic growth in Nigeria. Time series data from the WDI (2022) on: Real GDP, real interest rate, gross fixed capital formation, labour force size and institutional quality index (generated) were used. The Augmented Dickey-Fuller test and the Bounds Testing for cointegration were conducted. The ARDL estimation technique was employed. The findings indicate that institutional quality negatively and significantly impacts economic growth in Nigeria; and that a long-run relationship exists between institutional quality and economic growth.

[22], specifically examined the impact of government expenditure and institutional quality on economic growth. The study employed the Dynamic Ordinary Least Squares (DOLS) method to analyse time series data from 1990 to 2022. The findings indicate that government spending has a substantial and favourable effect on economic growth. Furthermore, the findings demonstrated that the presence of institutions had a substantial and favourable impact on the economic development of Nigeria. According to these findings, the study suggests that government spending should be consistently increased, but this should be accompanied with fiscal discipline through the execution of the regulatory framework of the Nigerian government.

[23], examined the appropriate concept and approach in overcoming the institutional problem. The Local Economic Independence approach was used in building their model by using 167 coconut farmer respondents, and path analysis was used as a data analysis tool. Research finding showed that 1) together and partially the local economic development variables; human resource development, capital development, market development, development of economic institutions, simultaneously and partially have a significant effect on Local Economic Development; 2) Direct development of economic institutions has effect on Local Economic Development; 3) development of economic institutions have interactive effect on Local Economic Development of coconut farmer in the Sri Tiga village of Banyuasin district. The results of the study showed that partially the variables of human resource development, capital development, market and social development have a significant effect on the development of community economic institutions. It is necessary to pay attention to 5 (five) factors, including: human resource factors, factors of capital, marketing factors, social (cultural) factors, as well as factors of community economic institution development. As for some factors that still have problems developing the business of coconut farmers in managing coconut waste in the village of Sri Tiga, among others, marketing factors, capital factors, and human resource factors.

3 Methodology

The study adopts the ex post facto research design. This research design is sometimes called causal-comparative research design. This is a type of research method in which the investigator studies the relationship between variables after the events have already occurred.

Theoretical Framework

The theoretical framework of this study is anchored on the New Institutional Economics (NIE) theory. New Institutional Economics (NIE) theory is a theoretical paradigm that attempts to incorporate a theory of institutions into economic analysis [24]. Now it is widely used in economic, political, and social analysis. The major research goals of NIE are to explain what the institutions are, how do they rise and change, how do they affect the economic, political and social life, and the like.

Various institutional economists have different definitions about institutions. In Veblen's view, "the concept of institutions is prevalent habits of thought with respect to particular relations and functions of the individual and society [25]." Commons proposed that institution is a collective action in control, liberation, and expansion of individual action. The new institutional economist, North stated that "institutions are the rules of the game of a society or more formally are the humanly devised constraints that that shape human interactions [26]."

Model Specification

This study is anchored on the endogenous growth theory which simply states that economic growth is driven by strong influences within the economy. The underlying assumption is that economic prosperity is primarily determined by internal or endogenous factors as opposed to external or exogenous factors. Starting with the simple AK model, which is the simplest form of the endogenous growth model and a straight forward extension of the Solow model as defined in equation 1:

$$Y = f(AK) \quad (1)$$

Where Y is the national output, K is the composite measure of capital stock, while A is a constant on the assumption of constant return to scale (CRS). The CRS replaces the assumption of diminishing returns to scale in the neoclassical growth theory to ensure that investment matters for long run growth and that growth is endogenous [27]. But capital stock can be subdivided into physical capital and human capital, hence the model becomes:

$$Y = A f(K, L) \quad (2)$$

Where L represents labour force

$$Y = AK + AL$$

(3)

If $y = Y/A$, then $k = K/A$, and $l = L/A$, then equation (3) can be re-written as follows:

$$y = \Omega_0 + \Omega_1 k + \Omega_2 l$$

Where; y represents output, k stands for physical capital, and l is human capital.

It is pertinent to note that the output in any economy will be influenced in one way or another by quality of institutions represented by iq . Hence, there is need to introduce institutional quality into the equation as follows:

$$y = \Omega_0 + \Omega_1 k + \Omega_2 l + \Omega_3 iq$$

(4)

The model specification in this study was anchored on the endogenous growth theory. The main objective of the study was to examine the effect of institutional quality on economic growth and development in Nigeria. The model to achieve the specified objectives are specified below:

Model

To examine the effect of institutional factors on economic growth in Nigeria, we specify

$$GDPGR = f(IQ, CAF, LAB)$$

(5)

Where

GDPGR = Annual growth rate of GDP

IQ = Institutional quality variables

CAF = Capital formation proxied by growth rate of total domestic investment (DOM) and FDI.

LAB = Labor force proxied by Labour force participation rate (% of Total Population ages 15 – 64).

Explicitly, model (5) can be re-written as follows:

$$GDPGR = \Omega_0 + \Omega_1 RULE + \Omega_2 REGQ + \Omega_3 COC + \Omega_4 DOM + \Omega_5 FDI + \Omega_6 LAB + \varepsilon$$

(6)

Where:

RULE = Rule of Law as a proxy for Institutional Quality, measured by its index.

REGQ = Regulatory quality requirements as a proxy for Institutional Quality, measured by its index.

COC = Control of corruption as a proxy for Institutional Quality, measured by its index.

DOM = Domestic Investment as control variable.

FDI = Foreign Direct Investment as control variable.

LAB = Labour force participation rate as control variable.

GDPGR = Gross Domestic Product Annual growth rate.

“ ε ” is the stochastic disturbance term representing all factors that have influence on the dependent variable but which are not explicitly taken into account.

“ Ω_0 ” denotes the intercept term, that is, the mean or average effect on dependent variable of all the variables excluded from the model, especially when all the explanatory variables are set at zero values.

4. Results

Table 4.1: Result of the Study

Variable	Coefficient	t-Statistic	Prob.
RULE	-8.419130	-2.458734	0.0237
REGQ	-1.710662	-0.457292	0.6526
COC	-1.079987	-1.690308	0.1073
DOM	0.005986	0.087948	0.9308
FDI	1.693198	2.276192	0.0346
LAB	-0.112038	-2.588780	0.0180
R-squared	0.669093		
Durbin-Watson stat	2.126658		

Source: E-Views 10 Output

Table 4.1 shows the regression result of model one investigating the effect of institutional factors on economic growth in Nigeria. The result reveals from the value of R^2 that the independent variables used in the study explained the variation of the dependent variable by about 67%. What this means is that the combined effect of rule of law (RULE), regulatory quality (REGQ), control of corruption (COC), domestic investment (DOM), foreign direct investment (FDI), and labour force participation rate (LAB) accounts for about 67% changes in the annual growth rate of the gross domestic product in Nigeria. The remaining 33% is unexplained by the model. With this, the model is robust and represents a good fit. Again the value of the Durbin-Watson being approximately 2 indicates absence of autocorrelation from the residual value. The implication of this is that the result is statistically well behaved.

The result reveals that out of the three institutional variables under consideration, only one is statistically significant and all of them negates the a priori expectations. This observation clearly shows how dysfunctional and weak

institutional factors are in explaining annual growth rate of GDP in Nigeria. Also for the control variables, domestic investment is not statistically significant, even though it is of the expected sign. Specifically, the result shows that for a unit improvement in the rule of law, annual growth rate of gross domestic product declines by about 8 units. Also, for a unit improvement in the regulatory quality, it should have resulted in the decline of annual growth rate of GDP by about 2 units. Control of corruption shows no improvement in the annual growth rate of GDP in Nigeria for the period under review. For a unit improvement in the control of corruption, it weakens the annual growth of GDP. The control variables shows that domestic investment, though not statistically significant, shows sign of slightly and positively contributing to the annual growth of GDP in the country. Foreign direct investment significantly improves the annual growth rate of GDP in the country. Specifically, a unit improvement in the FDI results to about 2 unit improvement in the annual growth rate of GDP. Surprisingly, labour force participation rate significantly show a declining contribution to the annual growth rate of GDP in the country.

The revelation from the result above shows a worrisome situation of institutional factors' impact on the annual growth rate of the gross domestic product in Nigeria. None of the institutional factors show indication of improving economic growth. This is not just only a worry but a call for serious concern. Rule of law shows to be statistically significant and also show to be the greatest culprit of the institutional factors in worsening economic growth. What this means is a near total collapse of trust in the entire legal framework in the country. The legal framework that upholds the rule of law has been porous therefore weakening the sustenance of growth rate of GDP. Of note again is the control of corruption which is statistically significant but contradicts the a priori expectation. What this implies is that the fight against corruption in the country has not been yielding the expected result. This is clearly showed as control of corruption negatively impacts on the economic growth in Nigeria.

5. Recommendations

Based on the findings of this study, the following policy recommendations are proffered.

1. Rule of law should be strengthened in the country. The result shows that rule of law is significant in deteriorating economic growth in Nigeria. The political elites and the rich should not bend the arm of law. This will help the workability of institutional framework in restoring the country to the path of sustainable growth.
2. The regulatory requirement is not significant in promoting economic growth in the country. The implication of this is that some laws made that should economic growth are not enforced or they are not country-specific both rather borrowed. Our law makers and other stakeholders of government policies should reassess the laws to ascertain their suitability in chatting the cause of economic growth in the country. Again, adequate monitoring and evaluation of the relevant laws should be a routine task of certain officers to ensure that the planned economic growth is attained.
3. Further, the control of corruption should be redesigned for effectiveness. The variable shows insignificant contribution towards promoting economic growth. This could be as a result of many Nigerians accepting some corrupt practices as a norm and a way of life. The National Orientation Agencies (NOA), the media, Schools and religious bodies should intensify the crusade and fight against corruption. The slogan of "Kill corruption before corruption kills us" should be enshrined in the system. The society should start by seeing corruption as a cankerworm and menace to economic growth.

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