

Financial sector development and economic growth in Nigeria

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Abstract

This study employs the Autoregressive Distributed Lag technique (ARDL) to investigate the impact of financial sector development on economic growth in Nigeria, considering previously overlooked variables. The findings from the Bound Co-integration Test indicate a long-run relationship between financial sector development and economic growth. Specifically, credit to the core private sector, market capitalization, total savings, and monetary policy rate are identified as drivers of economic growth, while credit to the government hampers growth. The study concludes that financial sector development facilitates economic growth by mobilizing and channeling financial resources effectively to the core private sector. To further promote economic growth, the study recommends the formulation of effective policies to enhance capital market activities in mobilizing long-term idle funds. Additionally, the government should ensure the judicious utilization of credit provided by the financial sector. This study contributes to existing research by reaffirming the influence of financial development on economic growth and considering crucial variables such as credit to the core sector, credit to the government, and monetary policy rate.

Keywords: Capital market; credit; economic growth; financial development n



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1. Introduction

The direction of the relationship between financial system development and economic growth has been a subject of discourse both theoretically and empirically. The theory suggests that financial sector development fosters economic growth and development through the effective and efficient mobilization of financial resources (Levine, 2004; Schumpeter, 1911). Robinson (1952) opined that adequate finance is essential for enhancing investment and real sector productivity, which are critical for promoting economic growth. This is because the availability of finance or credit facilitates the production of goods and services in the real sector, creating a multiplier effect across different sectors of the economy (Oriavwote & Eshienake, 2014; Egbo & Nwankwo, 2018). However, the availability of finance to the industrial sector and entrepreneurs is determined by the efficacy of financial institutions in mobilizing and directing financial resources to the real sector, which is a function of the developed financial sector. Allen and Santomero (2001) and Bist (2018) asserted that a developed financial system can source funds from the surplus sector at a low cost and direct them to the real sector. According to Shaw (1973), financial sector development has the potential to stimulate economic growth in both the short run and long run.

Over the years, especially since 1986, the Nigerian financial sector has undergone various reforms to enhance the performance of financial institutions. The economic and non-financial markets have experienced different reforms and policies to ensure that financial institutions effectively perform their intermediation functions and serve as drivers of growth and development by adequately financing the real sector and entrepreneurs (Okpara, Onoh, Ogbonna, & Iheancho, 2018). A deregulation policy was implemented in 1986 with the adoption of the Structural Adjustment Programme to correct the structural imbalances in the financial system. This policy liberalized the economy to promote effective and efficient performance in the financial sector. The aim of adopting this policy was to increase the size and implementation of the financial industry to foster growth and development (Madichie, Maduka, Oguanobi, & Ekesiobi, 2014). Additionally, the Structural Adjustment Programme was formulated to eliminate disintermediation, remove interest rate controls, and enhance effectiveness and efficiency in the intermediation process through financial services and instruments available to all sectors and populations in the economy.

Despite various policies and reforms aimed at enhancing the financial sector's performance, it is widely believed that the sector has been underperforming. Nkoro and Uko (2013) opined that the financial system has not been adequately supporting the growth and development of the economy as expected. Additionally, Adekunle, Sakami, and Adedipe (2013) stated that there is a weak connection between the financial sector and growth because the production and investment sectors, which are crucial for promoting economic growth, are not adequately financed by the industry. According to Gabriel, Afamefuna, and Baridam (2016), recent instability and bank failures in the financial system have negatively influenced customers' and depositors' confidence, leading to reduced savings and the financial sector's ability to finance significant growth drivers in the economy.

However, studies have emerged in recent years on the relationship between financial sector development and economic growth in Nigeria. The majority of this

literature focuses on the banking sector without addressing the capital market, which is an important component of Nigeria's financial industry (Abubakar & Gani, 2013; Madichie et al., 2014; Iheanacho, 2016; Okpara et al., 2018; Egbo & Nwankwo, 2018; Obamuyi & Faloye, 2018). Furthermore, most studies use total credit to the private sector as a proxy for financial development. In contrast, this study adopts credit to the core sector of the economy as a measure of financial products, as the core sector is the primary driver of economic growth in Nigeria.

Moreover, very few studies have employed total savings, which measure the resource mobilization capacity of the financial sector. Finally, in contribution to previous studies, this research used net credit to the government to assess the financial sector's ability to support government activities in creating a suitable environment and providing facilities to foster growth. Addressing the gap identified, this study explores the nexus between financial sector development and economic growth in Nigeria. The remainder of the paper is structured as follows: literature review, methodology, presentation of results, and conclusion.

2. Method

This study employed a quantitative research technique because it utilized numerical data. The focus was on the effect of financial sector development on Nigeria's economic growth from 1986 to 2018. All data for the analysis were sourced from the Central Bank of Nigeria Statistical Bulletin (2019). In collecting the data, the study concentrated on key variables, which include credit to the core private sector, market capitalization, monetary policy rate, total savings, net credit to government, and real gross domestic product.

The Bounds Co-integration test was used to determine the long-run relationship among the variables. This technique provides more robust results than other co-integration methods because it can investigate long-run relationships among variables of different integrations. Additionally, the Autoregressive Distributed Lag (ARDL) technique was employed to establish both the short-run and long-run effects of financial sector development on economic growth. This technique determines the speed of adjustment from short-run to long-run equilibrium while estimating the coefficients of each variable in a dynamic manner. One of the advantages of the ARDL test is that it is more robust and performs better with small sample sizes.

3. Empirical Result

This study adopts the Augmented Dickey-Fuller Unit Root Test to determine the stationarity and order of integration of the variables. The summary of the Augmented Dickey-Fuller Unit Root Test results reported in Table 1 indicates that credit to the government as a percentage of gross domestic product and the monetary policy rate are stationary at level. In contrast, the log of real gross domestic product, credit to the core private sector as a percentage of gross domestic product, market capitalization as a percentage of gross domestic product, and total savings as a percentage of gross domestic product are not stationary at levels but are stationary at first difference. Hence,

since the data series integrate at different orders and levels, the Autoregressive Distributed Lag (ARDL) Bound Testing approach was adopted.

Unit Root Test

Table 1. Unit Root Test at Level Form

Variables	Test Statistic	5% Critical Value	Prob.	Level	S/NS
LRGDP	-3.114380	-2.960411	0.0358	1(1)	S
CCPSGDP	-5.481712	-2.960411	0.0001	1(1)	S
MCAPGDP	-5.915939	-2.963972	0.0000	1(1)	S
CGGDP	-3.410994	-2.960411	0.0182	1(0)	S
MPR	-3.14970	-2.957110	0.0328	1(0)	S
TSGDP	-6.073742	-2.960411	0.0000	1(1)	S

Source: Researchers' Computation, 2020

Bound Co-integration Test

Table 2. ARDL Bounds Test Result

Critical Value Bounds		
Significance	I0 Bound	I1 Bound
5%	2.62	3.79
Estimated Bound F-statistic at k = 10.72561		
Note: conducted at lag III base on Akaike Information Criterion		

Autoregressive Distributed Lag Results

Table 3: Error Correction Model

Dependent Variable: LRGDP				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(CCPSGDP)	-0.007052	0.003242	-2.175091	0.0487
D(MCAPGDP)	0.005788	0.000918	6.305324	0.0000
D(MCAPGDP(-1))	-0.007104	0.002368	-2.999532	0.0102
D(MCAPGDP(-2))	0.003540	0.001903	1.859870	0.0857
D(CGGDP)	-0.004670	0.001388	-3.364239	0.0051
D(CGGDP(-1))	-0.002445	0.002098	-1.165361	0.2648
D(CGGDP(-2))	0.004330	0.001440	3.006372	0.0101
D(MPR)	0.002754	0.001068	2.578876	0.0229

D(TSGDP)	-0.009287	0.003903	-2.379512	0.0333
D(TSGDP(-1))	-0.009574	0.002104	-4.550740	0.0005
CointEq(-1)	-0.120244	0.014011	-8.582138	0.0000

Source: Researchers' Computation, 2020

The results of the ARDL-Bound test for long-run relationships are presented in Table 2. The results indicate a long-run relationship between financial development and economic growth in Nigeria, as the F-statistic value of 10.72561 at k is greater than the lower bound critical value of 2.62 at the 5% significance level. This implies that financial sector development significantly influences economic growth in the long run.

The results of the dynamic relationship between financial sector development and economic growth in Nigeria are presented in Table 3. The findings show mixed outcomes, with selected financial sector development variables having both negative and positive effects on economic growth at the current period, lag one, or further lags, as reported in Table 3. Finally, the co-integration equation has a value of -0.120244 with a corresponding probability value of 0.0000, which is statistically significant at the 5% level. This implies that there may be short run distortions, which will be corrected through the long-run adjustment mechanism. It indicates that short-term distortions in the variables are significant in their long term relationship, and 12% of this disequilibrium is corrected in the current period.

Table 4: Long Run Result

Dependent Variable: LRGDP				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CCPSGDP	0.072031	0.012581	2.461460	0.0042
MCAPGDP	0.131507	0.022058	5.961997	0.0000
CGGDP	-0.098652	0.009565	-10.313511	0.0000
MPR	0.086896	0.019740	4.402011	0.0007
TSGDP	0.036414	0.015590	2.335803	0.0362
C	8.435384	0.370561	22.763849	0.0000

The results of the long run analysis are presented in Table 4. The long-run impact shows that credit to the core private sector as a percentage of gross domestic product has a positive and significant effect on real gross domestic product. The implication of this finding is that an increase in the flow of credit from financial institutions to important sectors of the economy, such as manufacturing and agriculture, will enhance the performance of these sectors and, consequently, contribute to economic growth. This finding aligns with the results of Ekpenyong and Acha (2011), Yakubu and Affoi (2014), and Obamuyi and Faloye (2018); however, it is not supported by the results of Egbo and

Nwankwo (2018).

Similarly, market capitalization as a percentage of gross domestic product has a positive and significant effect on real gross domestic product. This implies that capital market development promotes the intermediation of long-term funds for investment purposes, stimulating economic growth. This finding is supported by the study of Nkoro and Uko (2013). However, credit to the government as a percentage of gross domestic product negatively affects real gross domestic product. This may result from the high rate of corruption in the country, where financial resources are diverted for personal use instead of being invested in long-term capital projects that would enhance economic activities and growth.

Furthermore, it was found that the monetary policy rate has a positive and significant effect on real gross domestic product. Finally, total savings as a percentage of gross domestic product has a positive and significant impact on real gross domestic product. This suggests that financial institutions' ability to mobilize savings promotes lending and enhances real sector activities, thereby fostering economic growth. This result contrasts with the findings of Puatwoe and Piabuo (2017).

4. Conclusions

The development of the financial sector is a necessary prerequisite for achieving growth. A well developed financial system can ensure the effective mobilization of idle savings and its efficient allocation in terms of credits to the real sector in promoting production activities and enhancing growth through the optimum utilization of assets. This study, in line with findings, concluded that financial sector development engenders economic growth through the effective mobilization and flow of financial resources to the core private sector of the economy.

The study recommends that more credit should be directed to key sectors of the economy, such as manufacturing, agriculture, education, and industrial sectors like mining and quarrying, to achieve high growth. Additionally, effective policies should be formulated to further develop and enhance capital market activities in mobilizing long-term idle funds by increasing the number of market participants. The government should ensure the judicious use of credit provided by financial institutions by investing in infrastructure to support economic activities and growth.

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