ANALYSIS OF FINANCIAL SECTOR REFORMS ON ECONOMIC GROWTH IN NIGERIA

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ABSTRACT

The Nigerian financial sector had undergone series of reforms aimed at repositioning the economy activities towards economic growth in Nigeria. Despite all the concerted efforts channeled to this sector with anticipated result to boost economic growth prove abortive. Thus, this study examined the relationship between financial sector reforms and economic growth in Nigeria. The study used time series data from World Bank indicators and Central Bank of Nigeria, Statistical Bulletin which spanned from 1986-2016. Data treatment was done through stationarity and cointegration tests. The unit root test showed that the variables were integrated at order on I(1) except economic growth and prime interest rate were integrated at order on I(0). The result of cointegrated established a long run relationship among the variables. The result further showed negative relationship between financial sector reforms proxied by market capitalization-GDP ratio and economic growth. By implication therefore, the variables contributed significantly to increase industrial output within the study period. However, it was found that positive relationship existed between economic growth, financial sector reforms proxied by credit to private sector and commercial bank loan and advances in the model. Finally, Granger Causality test established both uni and bi-directional relationship within the model. The study concluded that real economic growth is influenced by financial sector reforms in Nigeria. The study therefore suggested that the Central Bank of Nigeria and deposit money banks should institute policies that will stabilize the magnitude of the variables in Nigeria. An effective management and monitoring of all these key variables will in no doubt boost real economic growth in Nigeria.

Keywords: Financial sector reforms, Credit to private sector, market capitalization, Broad money.

1.0 INTRODUCTION

The Financial sector is in no doubt a very essential part of the economy of a nation and any reforms carried out in the financial sector extends to other parts of the economy representing a transformational moment for the economy and its people. Financial sector reforms however have been a regular characteristic and the extend of the financial development. The reforms have evolved in response to the several problems posed by developments in the economic system such as systemic crisis, computerization, trade liberalization, globalization, technological innovation, and financial crisis. In real sense, the financial sector does not only mean the banking sector, the banking sector only holds a major stake in the financial sector of the economy making it more pronounced than other sectors of the economy. Omankhanlen (2012) argues that financial sector reforms promote economic growth through stimulating investment and raising productive capacity in a given economy.

Financial reforms in Nigeria dated back to 1952, when the banking Ordinance was enacted. The deregulation of banking in 1986 provided the impetus for the Structural Adjustment Programme (SAP) in early 1986. The 1986 reform of the financial system saw a policy shift from direct control to a market based financial system, especially as regards monetary management, risk management and asset holding capabilities of the institutions. Several other reforms followed which include the consolidation policy in banking in early 2005 and insurance in 2007 and again banking reform in 2010.

The reason for the emergency reforms is to create a more efficient and stable system and enabling environment that will facilitate optimum performance in the economy. Johnston and Sundararajan (1999) argue that financial sector reforms provide a foundation for implementing effective stabilization policies and successfully mobilizing capital and money markets for effective and efficiency use in order to achieve higher rates of economic growth. Many developing countries have experienced successful financial sector reforms which have been accompanied by improvements in economic growth and efficiency of the financial system, while other developing countries, Nigeria inclusive have faced financial crises and disruptions to economic growth. Essentially, the extent and the magnitude of the relationship between financial sector reforms and economic growth have been persistently undermined in Nigeria.

The reforms were essentially aimed at repositioning the financial industry to enhance economic growth in Nigeria. Following the reforms, it is expected that, by a combination of the financial sector reforms will not only improve financial institutions but bring fostering economic growth. However, achieving economic growth through the financial sector reforms remained unachievable over the years. As a result of the significance of financial sector reforms on economic growth series of debate both empirically and theoretically among the scholars with different opinion. Omankhanlen (2012), Akakabota and Nmadu (2015); Emeka and Aham (2013); Obamuyi and Olorunfemi (2011), Jin, Lanfang, & Susheng (2012) opined that positive relationship exists between financial sector reforms and economic growth. while some studies found negative relationship between the variables (Ogun & Akinlo, 2011; Bhim, 2012. But, Kaushal (2014), Nzotta and Okereke (2009) found no relationship between the variables. As a result of inconclusive findings, this study seeks to re-examine the relationship between financial sector reforms and economic growth in Nigeria using fully modified ordinary least square (FMOLS) technique for the period 1986-2016. Following this introduction, the rest of the paper is planned as follows: Section two covers the literature review and theoretical underpinnings. Section three present the methodology of the study. Data analysis and interpretation of result is the main thrust of section four while section five deals with conclusion of the paper.

2.0 LITERATURE REVIEW

Financial sector reform is used to refer to a set of rules, plans and directives that is made to affect the operation of business within the banking industry. The Nigerian banking industry has undergone remarkable changes over the years, in terms of the number of institutions, ownership, operational structure and efficiency. Soyibo (2008) opined that changes have been influenced through the deregulation of the financial sector, technological innovations, supervisory and adoption of prudential standards. The reform was oriented towards an increased reliance on market forces, reduction of distortions in investment decisions and evolving a sound and efficient financial system. The reform focused on structural changes, monetary policy, interest rate administration and foreign exchange management. It

encompassed both financial market liberalization and institutional building of the financial sector.

In Nigeria, the financial sector has undergone remarkable reforms in terms of ownership structure, the depth and breadth of instruments employed the number of institutions established, the economic environment and the regulatory framework within which the system operates currently. The Nigeria financial system include banks, capital markets, insurance, pension asset managers and other financial institutions with the central bank as the apex institution (CBN, 2008).

2.4 Empirical Literature

Table 1: Summary of the Empirical Literature on Financial Sector Reforms and Economic Growth

No.	Study/Author's	Period of Country	Number of Country	Data Set	Econometrics use	Findings/Conclusion
1.	Akakabota and Mmadu (2015)	1986-2012	Nigerian Economy	Time-series	Linear regression model techniques	The result shows that there is a positive relationship between Deposit money bank credit claims and economic growth in Nigeria. Interest Rate (INRT), and Deposit Money Banks credit claims (DMBCC) conform to apriority expectations.
2.	Emeka and Aham (2013)	1980-2009	Nigerian Economy	Time-series	Co-integration and Error Correction Mechanism	The empirical results show that there is a positive effect of financial sector development on economic growth in Nigeria.
3.	Mike and Lawal (2012)		Nigerian Economy	Time series	OLS	The results indicate that all these variables have positive and significant impact on the output performance of SMEs in Nigeria. We therefore accept that financial sector reforms have positive impact on the growth of SMEs in Nigeria.
4.	Aniekan (2009)	1970-2009	Nigerian Economy	Time-Series and Model Technique	Co-integration and vector error correction model	The result also reveals that financial sector reforms significantly affect agricultural investments in Nigeria both in the long and short-run.
5.	Ogun and Akinlo (2011)	1970-2004	Nigerian Economy	Time series and model techniques	Descriptive statistics and Vector Autoregressive Model	The study found that the means of performance indicators-saving rate, investment ratio and growth of real GDP, were very low relative to pre-reform period and their correlation with financial indicators were mostly low or negative under reform.
6.	Manasseh, *et al* (2014)	1981-2010	Nigerian Economy	Time series	Vector Autoregressive Model.	The findings show that ia) bi-directional relationship between banking sector domestic credit and per-capita GDP; (ii) uni-directional causation running from foreign direct investment to per-capita GDP and; (iii) uni-directional causation running from per-capita GDP to domestic credit to the private

						sector.
7.	Kaushal (2014)	2001-2010	Zambian Economy	Time series	OLS	The findings show that Zambian economy has not been able to improve the level of financial deepening. However, Zambian record of economic performance during the recent past remains very impressive.
8.	Jin, *et al* (2012)	2001-2006	China Economy	Cross-session	GMM	The result suggests that most traditional indicators of financial development are positively associated with economic growth.
9.	Kurer (2010)	1979-2009	China Economy	Time series	Ordinary Least square	The financial liberalization suggests a positive impact of bank liberalization on the economy, there is no clear evidence found for development in the sense of financial liberalization in China's banking sector. Consequently the positive correlation between the development of the banking sector and the economic development cannot be drawn.
10.	Rousseau and Watche (2005)	1760-2003	Latin American	Time series	Dynamic panel techniques .	Their findings suggest that in the absence of stable financial institutions, financial liberalization may be counterproductive.
11.	Rousseau and Sylla (2001)	1970-1998	United State Economy	Time series	Vector autoregressive model	Found a strong support for financial led growth.
12.	Emeka and Aham (2013)	1980-2009	Nigerian Economy	Time series	OLS	The results show that there is a positive effect of financial sector development on economic growth in Nigeria.
13.	Omankhanlen (2012)	1980-2008	Nigerian Economy	Time series	OLS	An improvement in financial intermediation was considered a necessary condition for stimulating investment, raising productive capacity and fostering economic growth.
14.	Nzotta and Okereke (2009)	1986-2007	Nigerian Economy	Time series	Ordinary Least square method	They find that financial deepening did not support economic growth in Nigeria.
15.	Afangide (2009)	1970-2005	Nigerian Economy	Time series	Least square estimation technique	They discovered that a developed financial system alleviates growth financing constraints by increasing bank credit and investment activities with resultant rise in output. This show that developed financial system indirectly affect growth through investment.
16.	Das and Ghosh (2006)	1992-2002	Indian Economy	Time series	Nonparametric statistics and	The results reveals that medium-sized public sector banks performed considerably well and were more likely to operate at higher levels of

					Environment Analysis	technical efficiency.
17.	Obamuyi and Olorunfemi (2011)	1970-2006	Nigerian Economy	Time series	Co integration and error correction Model	The results demonstrate that financial reform and interest rates have significant impact on economic growth in Nigeria. The results imply that the behaviour of interest rate is important for economic growth in view of the empirical nexus between interest rates and investment, and investment and growth.
18.	Ogun and Akinlo (2011)	1970-2004	Nigerian Economy	Time series	Descriptive statistics and Vector Autoregressive Model	The study revealed that the means of performance indicators -saving rate, investment ratio and growth of real GDP, were very low relative to pre-reform period and their correlation with financial indicators were mostly low or negative under reform. Evidence from the VAR analysis also showed that shocks to financial indicators either had negative or insignificant positive effect on the saving rate investment and growth during reform.
19.	Olomola (1997)	1960-1996	Nigerian Economy	Time series	Ordinary Least square method	The study found that a positive and significant relationship exists between real private sector investment and financial deepening. He concluded that improved financial intermediation would help bridge the gap between domestic saving and investment in Nigeria.
20.	Lee and Chien (2008)	1959-2003	Taiwan	Time Series	VAR	They find that the variables taken in the regression have experienced shocks. Accounting for these shocks is essential to establish co integration relationship between tourism development and economic growth of Taiwan.
21.	Bhim (2012)	1965-2009	Nepal, Japan	Times series	Stationary test and OLS	The findings show that all variables except domestic credit are non-stationary at the level. When time series properties of variables that help to detect the impact of policy reforms are examined with a structural break, only economic growth experienced a shock, growing positively after the liberalization. Similarly, domestic credit provided by banks experienced negative growth, and it decreased in pace after policy reforms, which implies that the role of government declined after the liberalization.
22	Essien and	1987-	Nigerian	Time series	Co-	They found that there was no long-

	Onwioduokit (1998)	1993	Economy		integration test	run equilibrium relationship between savings and its various determinants.
23.	Ezirin and Muoghalu (2004)	1976-1985	Nigerian Economy	Time series	OLS	The paper concluded that the performance of commercial banks was significantly different under deregulated regime compared with regulated one.
24.	Iganiga (2010)	1970-1986	Nigerian Economy	Time series	Ordinary least square method	The results show that the performance of the financial sector has been greatly influenced over time by these reforms that began in 1986. The adoption of market determined cash reserve requirement caused cash intensity and domestic savings to increase by 5.54 and 5.00 percent respectively.
25.	Manasseh, *et al* (2012)	1981-2010	Nigerian Economy	Time series	Vector autoregressive (VAR) model and error correction model (VECM).	The following findings on granger causality test were noticed; (a) bidirectional relationship between banking sector domestic credit and per-capita GDP; (b) unidirectional causation running from foreign direct investment to per-capita GDP and; (c) unidirectional causation running from per-capita GDP to domestic credit to the private sector.
26.	Olofin and Afangideh (2008)	1970-2005	Nigerian Economy	Time series	Ordinary Least Square Method.	The study holds that a developed financial structure has no independent effect on output growth through bank credit and investment activities, but financial sector development merely allows these activities to positively respond to growth in output.
27.	Odenira and Udeaja (2010)	1960-2009	Nigerian Economy	Time series	VAR	The empirical results suggest bi-directional causality between some of the proxies of financial development and economic growth variable in Nigeria.
28.	Agu and Chukwu (2008)	1970-2005	Nigerian Economy	Time series	Granger causality and Toda Yamamoto test	Their findings revealed evidence to support both demand- and supply-leading hypotheses, depending on the financial deepening variable that is used.
29.	Levine, *et al* (2000)	1960-1995	Cross section and panel techniques.	Time series	GMM	They suggest that legal and accounting returns that strengthen creditor rights, contract enforcement and accounting practices can boost financial development and accelerate economic growth.

30.	Xu (2000)	1960-1993	Cross session	Time series	Multivariate vector autoregressive (VAR) Approach.	The results show that financial development is important to GDP growth and that domestic investment is an important channel through which financial development affects economic growth.

In summary, there is no consensus on the relationship between financial sector reforms and economic growth in Nigeria. The conclusions of these reviewed studies were diverged, ranging from positive to an inverse or no relationship and /or unidirectional or bi-directional or no directional between the variables. As a result, some of the studies in the literature reviews have little or no similar conclusion due to different economies, different methodologies and different period covered in different studies. Hence, this study is conceived to determine the relationship between financial sector reforms and economic growth and also determine the direction of causality between the identified variables in Nigeria.

3.0 METHOD OF ANALYSIS

The data for this study was sourced from secondary sources in Nigeria. The sources are various edition of the Central Bank of Nigeria Statistical Bulletin. Data on the identified variables spanned between 1986-2016. The study made use of the following data series:

Variable	Measurement

Dependent Variable:

RGDP	Real Gross Domestic product: proxy for economic growth

Financial Development Variables

SMCY	Capture by market capitalization-GDP ratio in an economy
BM2Y	This is measure by broad money supply-GDP ratio annually
CRPSY	The bank credit to private sector-GDP ratio
IRS	This is proxy by prime interest rate
LLY	Deposit liability-GDP ratio
LOAN	Money deposit banks loan and advances
INVR	Investment rate

The stationary tests and test for co-integration were first conducted. Thereafter, long run equation model were employed using FMOLS estimation technique was employed to determine the relationship between financial sector reforms and economic growth.

3.1 Model Specification

This study is anchored on Emeka and Aham (2013) with appropriate modifications. The model is written as:

$$InRGDP_t = \alpha_0 + \alpha_1 InSMCY + \alpha_2 InBM_2Y_t + \alpha_3 InCRPSY_t + \alpha_4 InIRS_t + \alpha_5 InLLY_t + U_1 \quad 1$$

Equation (1) was appropriate modified and this is specified as:

$$InRGDP_t = \alpha_0 + \alpha_1 InSMCY + \alpha_2 InBM_2Y_t + \alpha_3 InCRPSY_t + \alpha_4 InIRS_t + \alpha_5 InLLY_t + \alpha_6 InLOAN_t + \alpha_7 InINVR_t + U_2 \quad 2$$

4.0 RESULTS AND DISCUSSIONS

Table 1: Unit Root Test Results at level using Phillips-Perron

Variables	Test Statistic	0.05 Critical Value	Level	1st difference	Remarks
RGDP	(4.428578)	(2.967767)	I(0)*	-	S
SMCY	(2.830521)	(2.967767)	I(1)**	(6.259549)	S
BM2Y	(2.761188)	(2.967767)	I(1)**	(8.870519)	S
CRPSY	(2.469429)	(2.967767)	I(1)**	(7.989223)	S
IRS	(6.732095)	(2.967767)	I(0)*	-	S
LLY	(1.710052)	(2.967767)	I(1)**	(4.965190)	S
LOAN	(0.194807)	(2.967767)	I(1)**	(7.206575)	S
INVR	(2.083078)	(2.967767)	I(1)**	(8.342517)	S

Source: Researcher's Computation, (2018).

Where: S = Significance;
I(0)* = denotes stationary at level
I(1)** = denotes stationary at 1st difference

The Table 1 showed that the economic growth and prime interest rate data series were found stationary at level while market capitalization-GDP ratio, broad money stock-GDP ratio, credit to private sector, deposit liability-GDP ratio, commercial bank loan and advances and investment rate were found stationary at 1st difference in the estimated model.

Table 2: Test for Johansen Co-Integration Results

Result of Cointegration Test

Trace Statistic	0.05 Critical Value	Hypothesized No of CE(S)	Prob**
261.2920	159.5297	None *	0.0000
179.4013	125.6154	At most 1 *	0.0000
119.0350	95.75366	At most 2 *	0.0005
65.84301	69.81889	At most 3	0.0996
41.29153	47.85613	At most 4	0.1796
20.84972	29.79707	At most 5	0.3671
11.09640	15.49471	At most 6	0.2057
4.049752	3.841466	At most 7 *	0.0442
Max-Eigen Statistic	**0.05 Critical Value**	**Hypothesized No of CE(S)**	**Prob****
81.89070	52.36261	None *	0.0000
60.36637	46.23142	At most 1 *	0.0009
53.19195	40.07757	At most 2 *	0.0010
24.55148	33.87687	At most 3	0.4160
20.44182	27.58434	At most 4	0.3114
9.753314	21.13162	At most 5	0.7674
7.046649	14.26460	At most 6	0.4836
4.049752	3.841466	At most 7 *	0.0442

Source: Researcher's Computation, (2018).

The result of the cointegration test suggest that long run relationship exist among the variables of the model. while trace statistic showed evidence of four (4) cointegrating equation, Max-Eigen prove four (4) cointegrating vectors, as reported in Table 2 respectively. The study therefore estimates the long run parameters for the study using FMOLS for the period of study.

Table 3: The Empirical Results of FMOLS

Response variable: RGDP			
Variable	Coefficient	Std. Error	Prob.
SMCY	-0.885088	0.172251	0.0028*
BM2Y	-0.141687	0.307480	0.7129
CRPSY	0.394799	0.098395	0.0020*
IRS	0.063023	0.117028	0.5959
LLY	-0.538971	0.376671	0.5247
LOAN	0.049847	0.007082	0.0000*
INVR	0.600132	0.312581	0.7706
C	5.338243	1.918627	0.0061
R-Square	0.725364		
Durbin Watson stat	1.918657		

Source: Researcher's Computation, (2018).

The regression results for real economic growth model showed coefficients of all the independent variables are positively signed except market capitalization (SMCY), credit to private sector (CRPSY), and commercial bank loan and advances (LOAN) were all statistically significant at 5% level. The finding shows that a unit percent increase in market capitalization will lead to 89 percent decrease in real economic growth in Nigeria. The reason for this inverse relationship could be traced to a situation whereby excessive stock of money and capitalization would be in circulation and this tends to reduce the value of money in such an economy. Furthermore, the regressed result showed positive relationship between credit to private sector and commercial bank loan and real economic growth. This implied that a unit percent increase will lead to 40 percent and 5 percent increase in real economic growth in Nigeria and it is significant at 5% level. However, broad money stock-GDP ratio, prime interest rate deposit liability-GDP ratio and investment rate were found insignificant at 5% level for the period 1986-2016 in Nigeria.

In term of the relationship between deposit liability-GDP ratio (LLY) and real economic growth (RGDP), the study revealed that an inverse relationship in the model. The result implies that a unit percent increase in deposit liability-GDP ratio will bring about 54 percent decrease in real economic growth in the estimated model. More so, positive relationship existed between broad stock-GDP ratio and real economic growth and this implied that a unit percent increase in deposit liability-GDP ratio will bring about 14 percent decrease in real economic growth.

Moreover, direct relationship between credit to private sector-GDP ratio and real economic growth; it is statistically significant at 5% level. The result is agreement with the *a-priori* expectation in the estimated model. The empirical results showed that a unit percent increase in credit to private sector-GDP ratio will lead to 40 percent increase in real economic growth in Nigeria. Also, with this, prime interest rate still maintained positive relationship with real economic growth and this simply implies that a 1 percent increase in prime interest rate will bring about 6 percent increase in real economic growth in the estimated model.

In term of the relationship between prime interest rate (IRS) and real economic growth (RGDP), the study showed that direct relationship in the model. The result implies that a unit percent increase in IRS will bring about 6 percent increase in real economic growth in the model. Finally, positive relationship existed between investment rate and real economic growth and also agreed with the a-priori expectation in the model. The finding shows that a

unit percent change in investment rate will lead to about 60 percent change in real economic growth in Nigeria. Furthermore, the R-square for real economic growth model was 73%, showing that the variables explained 73 percent of the systemic variation in the estimated model. Moreover, the value of Durbin-Watson statistic is marginally close to 2, i.e. 1.918657; then, the study implies that there is absence of auto-correction in the estimated model.

Table 4: The Empirical Results of Pair-Wise Granger Causality Test

Null Hypothesis	F-statistic	Prob.	Decision
SMCY does not Granger Cause CRPSY	4.66209	0.0200	
CRPSY does not Granger Cause BM2Y	13.2554	0.0001	
BM2Y does not Granger Cause IRS	3.48942	0.0475	
CRPSY does not Granger Cause IRS	4.37291	0.0246	
CRPSY does not Granger Cause LLY	3.97420	0.0329	
CRPSY does not Granger Cause LOAN	2.58569	0.0971	
IRS does not Granger Cause INVR	2.76457	0.0840	
LOAN does not Granger Cause LLY LLY does not Granger Cause LOAN	2.65718 3.52051	0.0916 0.0464	

Source: Researcher's Computation, (2018).

The result shows that market capitalization granger cause credit to private sector in Nigeria and it is statistically significant in the model. Furthermore, credit to private sector granger cause broad money stock-GDP ratio whereas broad money stock-GDP ratio grangers cause prime interest rate in the model. Similarly, credit to private sector also affect prime interest rate; credit to private sector influence deposit-GDP ratio in the model. More so, the empirical result shows that credit to private sector granger cause commercial bank loan and advances and prime interest rate and prime interest rate granger cause investment rate in the model. However, there is bi-directional relationship in the case of commercial bank loan/advances and deposit liability-GDP ratio indicated in the Granger Causality estimation within the period of study. Using Granger Causality test, established uni and bi-directional relationship within the study.

5.0 CONCLUDING REMARKS

The study examined the relationship between financial sector reforms and economic growth in Nigeria for the period of 1986-2016. The study concluded that economic growth increased as financial sector reforms developed during the study period using FMOLS. This implies that Nigeria as an economy needs to continue search for stable and sustainable financial sector reforms towards economic growth, although care must be taken to be as holistic as possible that is taking care of macro-economic loopholes that have rendered previous approaches futile in Nigeria. Therefore, the study suggested that the Central Bank of Nigeria and Deposit Money Banks (DMBs) should institute policies that will stabilize the magnitude of the financial sector reforms so as to boost economic growth in Nigeria. An effective management, supervision and monitoring of all these key variables will in no doubt boost economic growth in Nigeria.

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