Financial Development and Economic Growth in Nigeria (1986-2020)

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ABSTRACT

This study examined financial development and economic growth in Nigerian from 1986 to 2020 using data sourced from the CBN statistical bulletin (2020). The Nigerian financial sector is fraught with fissures that have frustrated its potential to facilitate economic growth, Funds accumulated by financial intermediaries are insufficient to cater for the desired level of economic growth. The objective of this study is to find out how financial development has influenced the economy. Financial development was measured by money supply to GDP, insurance premiums to GDP, Stock market capitalization to GDP and private sector credit to GDP while economic growth was represented by real GDP. The study adopted the ex-post facto research design in conducting the research. The data was subjected to statistical analysis using the Ordinary Least Square regression. The findings of the study revealed that money supply to GDP and Market capitalization to GDP has positive and significant relationship with economic growth in Nigeria while private sector credit to GDP and insurance premiums to GDP ratio had negative relationship with economic growth in Nigeria. The study recommends that Credit to private sectors should be channeled to the real sector of the economy which will lead to economic growth .The monetary authorities should also ensure adequate supply of money to facilitate economic transactions for economic growth to desired levels, The monetary authorities should develop policies that aids entry of more establishments into the capital market and Insurance policies should be made to ensure the relevance and increased patronage of insurance sector in Nigeria .

Keywords: *Economic Growth, Financial Development*

1.0 INTRODUCTION

Financial development is the means of developing and intensifying financial establishments and services. it is also an enhancement in the delivery of financial assets in the economy. Banks and other financial institutions engage premeditated positions in the operation of any economic scheme and serve as the device through which economic activities revolves. This supports the economic theory that the financial sector of any economy is an engine of growth and development. According to Nwakobi, Oleka and Ananwude (2016) the opportunity that is needed to sustain growth in an economy is enhanced by the adroitness of liquid money . The

Nigerian financial and economic ambiance has witnessed substantial improvement. Growth is enhanced by the development of the financial system, which makes financial products/services accessible and affordable. Financial development is to improve economic conditions through increased competitive efficiency within financial markets thereby indirectly benefiting non-financial sectors of the economy. Financial development also helps in increasing the provision and choices of financial services (Nwolisa & Cyril, 2019). In the Nigerian economy there are several financial institutions offering separate services to the general public. They include banks, insurance, capital market, pension and mortgage institutions. These institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation or decline (Igwebuike, Udeh & Okonkwo, 2019). The financial sector performs critical activities such as the provision of securities markets, fund management, insurance, pension services and risk management. The target of every country is to achieve a sustainable economic growth that will lead to economic development in the long-run and many sectors of the economy contribute to the growth of a nation. Financial intermediaries supported the efforts of these sectors by mobilization and allocation of funds in order to boost their activities. Nigeria has been making economic policies in order to be part of global reality in developing the financial system. These activities encouraged mobilization and allocation of funds to various sectors of the economy. The relationship between financial development and economic growth has been an increasing inclination in the world and has incessantly remained a leading issue at any point in time. This attention is well-justified, since a better understanding of how the financial sector contributes to economic growth has important regulatory implications (Kolawole, Ijaiya, Sanni & Aina, 2019).

The Nigerian financial sector is plagued with clefts that have frustrated its potential to facilitate economic growth. A large portion of the Nigerian population are still financially excluded, Funds accumulated by financial intermediaries are insufficient to cater for the desired level of business growth Also, the insurance industry has a spun out indifference from the Nigerian populace due to mistrust, cultural and religious inclinations and delay in settling claims. In the stock market investors are drained of the low level of liquidity reflected on the low market capitalization to GDP ratio.

In respect to the challenges, efforts have been made by Nigerian monetary authority towards reforming the Nigerian financial sector. Despite structural, institutional and policy reforms to enhance the smooth functioning of the financial institutions to enhance the economy , the Nigerian financial sector has not been able to live up to its expectation as the boost of economic growth and development. The chief aim of the study is to determine the influence of the financial development on economic growth in Nigeria based on the relative contribution of the banking and non- banking financial Institutions..

Financial development is decomposed to include; money supply to GDP ratio, private sector credit to GDP ratio, Insurance premiums to GDP ratio and stock market capitalization to GDP ratio. On the other hand real GDP is the selected proxy for economic growth.

2.0 LITERATURE REVIEW

2.1 Conceptual Framework

2.1.1 Concepts of Financial development

Financial sector consists of institutions, markets, instruments, including the legal and regulatory framework that allows transactions to be made through the extension of credit. Generally, financial sector development revolves around overcoming costs incurred in the financial system. It involves the methods of reducing the costs of acquiring information, enforcing contracts, and making transactions which culminates in the emergence of financial contracts, markets, and intermediaries. The five major functions of a financial system are: the production of information ex-ante about possible investments and the allocation of capital; the monitoring of investments and exertion of corporate governance after providing finance; the facilitation of trading, diversification, and management of risk; the mobilization and pooling of savings; and, the ease of exchange of goods and services (World Bank 2014). According to the International Monetary Fund (IMF) financial development occurs when sectors and agents use a range of financial markets for savings and investment decisions; financial intermediaries and markets deploy larger volumes of capital and handle larger turnover while financial sectors create assets for risk-sharing purposes.

2.1.2 Concept of Economic Growth

Economic growth is the increase in the amount of goods and services produced by an economy over a period of time. It is conventionally measured as the percentage rate of increase in real gross domestic product, or real GDP. Economic growth can be measured as a percentage change in the Gross Domestic Product (GDP) . The major source of per capital output in any country; whether developing or developed, with a market economy or centrally planned is an increase in productivity. According to Kolawole, Ijaiya, Sanni and Aina. (2019), economic growth is measured by the increase in the amount of goods and services produced in a country. Economic growth occurs when an economy's productive capacity increases which, in turn, is used to produce more goods and services.

2.2 THEORETICAL REVIEW

Theory of Financial Intermediation

This study is anchored on theory of financial intermediation which was propounded by Schumpeter (1911) . It advocates that financial intermediaries play a fundamental role of intermediation in the growth process by transferring financial resources from the net savers to net borrowers, thus influencing investment and thereby economic growth. The theory suggests that financial intermediaries can overcome a market failure and resolve an information asymmetry problem by transforming the risk characteristics of assets. The work of Schumpeter (1911) supports the view that well-functioning financial intermediaries can promote the overall economic efficiency. By pooling and allocating funds, financial intermediation promotes entrepreneurship and innovation which are necessary components for economic growth and development.

2.3 Empirical Review of related literature

In an attempt of determining the influence of financial development on economic growth, many scholars have carried out related studies from which some are reviewed in this study.

Efanga, Ogochukwu and Ugwuanyi (2020) investigated the impact of financial deepening on the Nigerian economy between 1981 and 2018. Data employed for this study was obtained from Central Bank of Nigeria Statistical Bulletin . This study employed real gross domestic product as proxy for economic growth in Nigeria, while ratio of money supply to gross domestic product, ratio of private sector credit to gross domestic product and ratio of market capitalization to gross domestic product were adopted as regressors. Inferential results generated indicated that financial deepening had positive impact on the Nigerian economy within the period under review. Eke, Okoye and Evbuomwan (2020), carried out a study on entrepreneurship and financial deepening in selected African economies from 1995- 2014 and evidence from the augmented Toda-Yamamoto technique , the result shows that human capital does not have long run causal effect on entrepreneurship , and financial deepening. Osasere , Bashiru and Ehis(2020) examined the impact of financial deepening on economic growth in Nigeria, using an annual data covering the period of 1990 – 2017 . Multiple regression techniques were used, error correction model was conducted to test the long run equilibrium of the model. Findings revealed that the variable has a long run effect on economic growth since the ECM result reveals a negative and significant relationship. Also based on the short run test, the result reveals that there is a negative and insignificant relationship between the ratio of credit to private sector to gross domestic product (CPS_GDP) and gross domestic product (GDP). There is also a negative and insignificant relationship between inflation rate (INFL) and gross domestic product (GDP).Furthermore, the result showed that there is a positive and insignificant relationship between the ratio of gross fixed capital formation to gross domestic product and gross domestic product (GDP).Also, it was found that there is a negative and insignificant relationship between the ratio of money supply to gross domestic product in the economy and gross domestic product (GDP).

Samuel-Hope, Ehimare and Osuma (2020) explored the effect of financial deepening on Nigeria's growth for 38 years covering 1981- 2018. The main research goals were to investigate the linkages among time and savings deposit of commercial banks, money supply and credit to the private sector on the economy's growth. Data was obtained from CBN Bulletin different issues and analyzed using Autoregressive Distributed Lag. From the result of analysis, the long run relationship existed but no regressor was found to be significant. Credit to the private sector to GDP was inversely related to GDP growth whereas money supply to GDP had positive relations with economic growth rate, time and savings deposits in commercial banks negatively affected national growth.

Igwebuike, Udeh and Okonkwo (2019) examined effects of financial deepening on the economic growth of Nigeria (1981 to 2016) through two of the basic arms of the financial industry (Insurance companies and Banking Industry). Secondary data from CBN statistical bulletin and Global Financial Development bulletin, 2017 as provided by the World Bank were utilized. The analytical tool used was Ordinary Least Squares (OLS). It was found that insurance industry premium to GDP has positive but no significant effect while credit to private sector by commercial banks to GDP has positive and significant effect on economic growth in Nigeria. Nwolisa and Cyril (2019) examined the impact of financial deepening on the growth of Nigerian

-economy 1990-2016. The main objective of this study is to evaluate the effect of private sector credit, money supply and market capitalization on economic growth in Nigeria. The sources of data for this study are CBN statistical Bulletin and National Bureau of Statistics. The data obtained were analyzed using ordinary least square regression (OLS). The result of the analyses showed that the three independent variables of the study all have significant effect on Nigerian financial deepening. Ogbonna (2018), examined the impact of financial deepening on economic growth in Nigeria between 1970 and 2015, using Vector Error Correction Model, Impulse Response Function, and Forecast Error Variance Decomposition, with a distinction between size and activity variables of financial deepening. The results show that financial deepening and economic growth have a stable long-run relationship, and that activity variables of the financial deepening have more stimulating effect on economic growth than the size variables.

Paul (2017) examined the impact of financial deepening on economic growth in Nigeria,using data from secondary sources, (1986-2015). He employed the ordinary Least Square (OLS)technique, Co integration, and Error correction model (ECM) as estimation tools. The results revealed that economic growth in Nigeria in the long-run is influenced by the indices of financial depth. Also financial deepening is positively and significantly related to economic growth. Taofeek and Olumuyiwa (2016) examined the relationship existing between financial development and inclusive growth for the period of 1980 to 2013. They employed the quantile regression-based threshold analysis. The result of their analysis revealed a 90th percentile threshold level, and that the impact of financial development on inclusive growth is determined by the measure of the previous threshold level. Also, the study found that trade openness and capital investment are necessary for inclusive growth in Nigeria.

Muhsin and Şerife(2016) examined the role of financial development on entrepreneurship by employing panel data estimation methods for 17 emerging markets economies over the period 2004-2009. In order to determine the linkages among the variables, two different measures for financial development and three institutional factors were utilized in the analysis. Empirical findings indicated that while financial development and per capita income level have significantly and positively impact on entrepreneurship theoretically

Saaed and Hussain (2015) examined empirically the causal relationship among financial development, trade openness and economic growth by using vector autoregressive technique in Kuwait for the period 1977-2012. The econometric methodology employed was the Cointegration and Granger Causality test. Granger causality tests based on VAR models show that there is a causal relationship between economic growth and financial development and between the trade openness of the economy and economic growth.

Rehman, Ali, and Nasir (2015) examined the relationship between financial development, savings and economic growth in Bahrain from 1981 to 2013 using the vector Auto Regression (VAR) model. They used M2/GDP to capture financial development, economic growth was captured by GDP per capita and savings measured as domestic savings/GDP. Their results showed that there is a bi-directional causality between savings and economic growth. Ebiringa and Duruibe (2015) used vector autoregressive model to analyze the relationship between financial system development and economic growth in Nigeria. The empirical results reveal that there is no long run causality from financial system development indicators to growth. This implies that the role of the financial institutions in terms of credit access to the less privileged

played towards the output growth has been less significant in Nigeria. In the short-run, the effect of financial development on economic growth was positive.

Victor and Samuel (2014) examined empirically, the implications of financial development for economic growth in Nigeria, using time series data covering the period between 1990 and 2011 from Nigeria. The co integration technique with its implied Error Correction Mechanism (ECM) was applied. This commenced with the ADF unit root test, followed by the Johansen co integration test. The variables included Real Gross Domestic Product, Financial deepening which is a ratio of money supply to Gross Domestic Product, liquidity ratio, interest rate and credit to the private sector. Financial sector development has not significantly improved private sector development. The minimum capital base and liquidity ratio has improved the level of economic growth in Nigeria. The Johansen co integration test suggests a long run relationship among the variables and the significant ECM which is negatively signed supports the long run relation among the variables and indicates a satisfactory speed of adjustment. Abdulsalam and Gani (2013) examined the long run relationship between financial development indicators and economic growth in Nigeria over the period 1970-2010. Using the Johansen and Juselius (1990) approach to co integration and Vector Error Correction Modeling (VECM). The findings of the study revealed that in the long-run, liquid liabilities of commercial banks and trade openness exert significant positive influence on economic growth, conversely, credit to the private sector, interest rate spread and government expenditure exert significant negative influence.

Nkoro and Uko (2013) investigated the nexus between financial sector development and economic growth in Nigeria using annual time series data from 1980 to 2009, within the cointegration and Error Correction analytical framework. The ratios of broad money stock to GDP, private sector credit to GDP, market capitalisation to GDP, banks deposit liability to GDP and prime interest rate were used as proxy financial sector development, while real GDP was used as proxy for financial economic growth. The study revealed a positive relationship between sector development and economic growth. Odeniran and Udeaja (2010) examined the relationship between financial sector development and economic growth in Nigeria, using Granger causality tests in a vector autoregressive (VAR) framework, over the 1960 period to 2009. The results indicated a bi-directional causality between some of the proxies of financial development and economic growth variable.

3.0 RESEARCH METHODOLOGY

This study adopted the *ex-post facto* research design in examining the influence of financial development on economic growth. The time series data on GDP, market capitalization, insurance sector premium, private sector credit to GDP and money supply to GDP were all obtained from the CBN statistical Bulletin (2021).

Model of the Study

This study adapted and modified the model of Odeniran, and Udeaja (2010) to investigate the relationship between financial development and economic growth in Nigeria. The study expresses real GDP per capita to measure real growth rates. However, a limitation of studies on the financial sector is that there is no single measure of financial sector development, therefore,

instead of a single proxy; three measures were adapted from the work of Odeniran, and Udeaja (2010) and one additional measure was introduced in this study in order to improve the robustness of the results. In this study however, GDP is measured as a function of insurance premiums to GDP ratio (INPG), Private Sector Credit to GDP ratio (PSCG), Market Capitalization to GDP ratio (MCG) and Money Supply to GDP ratio (MSG).

The functional model is expressed in equation 1 thus;

GDP = *f*(PSCG ,MSG, MCG, INPG) ……... 1

The econometric model of the study, which accounts for econometric parameters is shown in equation 2

$GDP = \alpha_0 + \alpha_1 PSCG + \alpha_2 MSG + \alpha_3 MCG + \alpha_4 INPG + \mu_t$ …… 2

α_0 is the intercept or the constant term; which is the value of the left-hand variable irrespective of the right-hand variable. α_1, α_2, α_3 and α_4 are the coefficients of the regression. μ_t is the error term of the regression.

Instruments for Data Analysis

P-value: The p-value procured by the OLS regression estimates will be used to test the research hypothesis. The p-values show the significance of the relationship between the independent variable and the dependent variable.

Decision Rule: The decision rule is to accept the null hypothesis of no significant effect if the p-value is greater than the chosen level of significance, which is 5% (0.05), otherwise reject the null hypothesis and accept the alternate hypothesis.

4.0 DATA ANALYSIS

Table 4.1: Descriptive Statistics

	RGDP	PSCG	MSG	MCG	INPG
Mean	38574.98	11.90285	15.80608	12.27478	0.640117
Median	31709.45	8.616549	13.09368	10.21907	0.444108
Maximum	71387.83	22.75484	24.89526	39.95008	1.919697
Minimum	15237.99	5.806165	8.464230	3.053435	0.288778
Std. Dev.	20476.78	5.596864	5.409021	8.634904	0.470564
Skewness	0.438826	0.562027	0.401069	0.985437	1.752000
Kurtosis	1.576325	1.576468	1.520643	3.993661	4.621111
Jarque-Bera	4.079137	4.797830	4.129888	7.104568	21.73795
Probability	0.130085	0.090816	0.126825	0.028659	0.000019
Sum	1350124.	416.5997	553.2127	429.6174	22.40409
Sum Sq. Dev.	1.43E+10	1065.046	994.7552	2535.093	7.528634
Observations	35	35	35	35	35

Source: *Eviews 11.0 Descriptive Statistics Output, 2021*

As shown in table 4.1, RGDP averaged 38,574.98 billion naira over the period under review, with its highest figure standing at 71,387billion naira. On the average, private sector credit was 11.9% of Nigeria's GDP, with a minimum value of 8% and a maximum of 22.75%. Money supply is about 15% of Nigeria's GDP on average and is maxed at 24.89% with its lowest value at 8.46%. Market capitalization also averages 12.27% of Nigeria's economic growth and peaks up to 39.97% while falling to as low as 3.05 over the studied period. However, insurance sector has not performed anywhere as high as the other examined sectors as it averaged 0.64% of Nigeria's GDP and has its highest value below 2% (1.91%).

Ordinary Least Square Regression

The result of the ordinary least square regression is shown in table 4.2;

Table 4.2: OLS Regression

Dependent Variable: RGDP
Method: Least Squares
Date: 11/29/21 Time: 08:44
Sample: 1986 2020
Included observations: 35

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PSCG	-64.78535	717.9612	-0.090235	0.9287
MSG	2878.187	756.4721	3.804749	0.0007
MCG	476.7652	184.5244	2.583752	0.0149
INPG	-5996.683	2641.131	-2.270498	0.0305
C	-8160.338	5289.026	-1.542881	0.1333

R-squared	0.915231	Mean dependent var	38574.98
Adjusted R-squared	0.903929	S.D. dependent var	20476.78
S.E. of regression	6346.858	Akaike info criterion	20.48087
Sum squared resid	1.21E+09	Schwarz criterion	20.70306
Log likelihood	-353.4152	Hannan-Quinn criter.	20.55757
F-statistic	80.97580	Durbin-Watson stat	1.019462
Prob(F-statistic)	0.000000		

Source: *Eviews 11.0 Regression Output, 2021*

PSCG and GDP: Based on the regression coefficient of -64.785, it can be envisaged that every percentage increase in the private sector credit to GDP ratio will coincide with a 64 billion naira decline in GDP. This result however, shows statistically insignificant with a p-value above 0.05. The results of the OLS regression reveals that private sector credit negatively influences economic growth in Nigeria.

MSG and GDP: On the other hand, money supply to GDP was found to be positive. With a coefficient of 2,878.81, percentage increases in money supply is expected to coincide with 2.88

trillion naira increase in the value of real GDP in Nigeria. With the corresponding p-value below 0.05, the result is statistically significant.

MCG and GDP: On the other hand, market capitalization to GDP was found to be positive. With a coefficient of 476.76, percentage increases in market capitalization to GDP ratio is expected to coincide with 476 billion naira increase in the value of real GDP in Nigeria. With the corresponding p-value below 0.05, the hypothesis is statistically significant.

INPG and GDP: Insurance sector has a negative influence on economic growth in Nigeria. It follows that with a coefficient of -5996.68, any percentage increase can be alongside a decline of 5.99 trillion naira in Nigeria's real GDP. This prediction is also statistically significant as the probability value is 0.031 which is below 0.05.

The F-statistic is 80.97 and the probability value of 0.000 reveals that the overall relationship between economic growth and financial development in Nigeria is significant. The R-squared value further reveals that 91% of the trend behaviour of Nigerian economic growth can be explained by the combined variations of private sector credit to GDP, Money supply to GDP, market capitalization to GDP and insurance premiums to GDP..

Discussion of the Findings

The study examined the effect of financial development on economic growth in Nigeria using econometric evidence from 1986 to 2020. The results showed that private sector credit to GDP has a negative influence on economic growth in Nigeria. It shows that the amount of credit extended to the private sector negatively influence the level of economic growth. The prediction was however found to be statistically insignificant. This findings is quite similar to the findings of Osasere, Bashiru and Ehis (2020) who found that there is a negative and insignificant relationship between the ratio of credit to private sector to gross domestic product (CPS_GDP) and gross domestic product (GDP).

The results showed that money supply to GDP has a positive influuence with economic growth in Nigeria in line with priori expectations. It shows that the volume of money which facilitates economic transactions positively effects the level of economic growth. The result was also found to be statistically significant. This finding is also in line with the findings of Samuel-Hope, Ehimare and Osuma (2020) which revealed that money supply to GDP had positive relations with economic growth rate.

The results showed that stock market capitalization to GDP has a positive relationship with economic growth in Nigeria in line with priori expectations. It shows that depth of the Nigerian capital market positively effects the level of economic growth. The result was also found to be statistically significant. This finding confirms the recent findings of Kolawole, Ijaiya, Sanni and Aina (2019) and Nwolisa and Cyril (2019) who found that capital market related financial development variable is a positive and significant determinant of economic growth in Nigeria.

The results of the analysis also showed that insurance premiums to GDP has a negative relationship with economic growth in Nigeria. It shows that the amount of premium accumulated by the insurance sector negatively influences the level of economic growth. The prediction was also found to be statistically significant.

5.0 CONCLUSION AND RECOMMENDATIONS

Based on the findings of the study, the financial development in Nigeria has not fully influuenced economic growth to desired effects, based on the findings of this study, the researcher makes the following recommendations;

1. To reduce the prevalence of non performing credits, Credit to private sectors should be granted with better conditions such as convenient interest rates, ensure that private sector credits are channeled to the real sector of the economy which will lead to economic growth
2. The monetary authorities should ensure adequate supply of money to facilitate economic transactions for economic growth to desired levels
3. The monetary authorities should develop policies that aids entry of more establishments into the capital market so as to ensure their standardization and further boost economic productivity.
4. Insurance policies should be made to ensure the relevance and increased patronage of insurance sector in Nigeria thereby improving its role to economic growth.

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