FINANCIAL INCLUSION AND INCLUSIVE GROWTH IN NIGERIA

By

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Abstract
Financial inclusion entails access of the populace to financial services to tackle poverty, improve welfare and general standard of living; which consequently promote economic growth. Using a battery of econometric tests, this paper explores the long run relationship between financial inclusion and economic growth in Nigeria between 1981 and 2014. Based on the specified regression model, money supply, liquidity ratio and credit to the private sector appear to be the major drivers of economic growth in Nigeria. The study also validates the finance led growth hypothesis and established that finance causes growth in Nigeria. The implication of our findings is that policy makers need to focus more on long run financial policies that can enhance effectiveness of the financial sector (both money and capital markets) in promoting growth. Also, the government should provide enabling environment and create awareness that can engender more public trust in the country's financial system.

Keywords: Financial Inclusion; Inclusive growth; Real GDP; Money supply; Demand deposit

JEL Codes: G21, O16

Introduction

Economic growth fosters development through financial inclusion; on the other hand, financial inclusion enhances wealth creation and consequently economic growth. Studies (Rajan and Zingales, 2003; Levine and Zervos, 1998) showed that access to financial services enhanced economic growth, tackles poverty, improves welfare and general standard of living and broadly promotes economic development. It could also lead to increase in saving mobilisation as currency outside the banking system would be minimal. Moreover, survey of the role of savings in economic development revealed that countries with higher saving rates have the tendency to grow at a faster rate than the countries with low saving rates. To this end, World Bank posits that policies that promote saving are important in developing countries because higher saving will contribute to higher economic growth (World Bank, 1993).

Sarma and Pais (2010) identified the benefits of an inclusive financial system to include: facilitating an efficient allocation of resources and a potential reduction in the cost of capital; an improvement in the day to day management of financial resources; and a reduction in the growth of informal sources of finance. Given its potential to increase household saving, enhance access to credit, provide capital for investment, promote entrepreneurship and allow more people to invest in themselves and their families; financial inclusion is regarded as an important means of ensuring that economic growth performance is inclusive (Triki and Faye, 2013) and broadens the resource base of the financial system by developing a culture of savings among large segment of rural population and plays role in the process of economic development (Joseph and Varghese, 2014). It promotes culture of saving and effective payment mechanism by strengthening the resource base of the financial institution which benefits the economy to the extent that availability of resources will bring about efficient payment mechanism and allocation. It mobilizes savings, promotes financial literacy of the rural population and hence guides them to avoid the dubious and unscrupulous elements that engage in unreliable financial services and thus improve their livelihoods.

The United Nations (AusAids, 2010) defines the goals of financial inclusion as: access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance; sound and safe institutions governed by clear regulation and industry performance standards; financial and institutional sustainability, to ensure continuity and certainty of investment. The global pursuit of financial inclusion as a vehicle for economic development has positive effects in emerging economies. Moreover, The World Bank postulated that the global goal of universal access to basic transaction services is an important milestone toward full financial inclusion which is a world where everyone has access and can use the financial services he or she needs to capture opportunities and reduce vulnerability (World Bank, 2013).

The global pursuit of financial inclusion as a vehicle for economic development has a positive effect in emerging economies. Specifically, adult Nigerians with access to payment services is to increase from 21.6 percent in 2010 to 70 percent in 2020, while those with access to savings should increase from 24 percent to 60 percent; and credit from 2% to 40 percent, insurance from1% to 40 percent and pensions from 5% to 40 percent, within the same period. The channels for delivering the above financial services were equally targeted to improve, with deposit money bank branches targeted to increase from 6.8 units per 100,000 adults in 2010 to 7.6 units per 100,000 adults in 2020, microfinance bank branches to increase from 2.9 units to 5.5 units; ATMs from 11.8 units to 203.6 units, POSs from 13.3 units to 850 units, Mobile agents from 0 to 62 units, all per 100,000 adults between 2010 and 2020 (CBN, 2010).

Financial inclusion is a contemporary issue, aimed at addressing deficiencies hampering economic growth, and ensuring broad-based benefits of economic growth. Inclusive growth debate is a global context in the orbit of rising inequality, high levels of unemployment, persisting poverty, and increasing unsustainable human development or welfare. In 2014, the GDP Rebasing exercise raised Nigeria's rank ahead of South Africa as the largest economy in Africa by GDP though at $2,688 GDP per capita but her economic growth remains exclusive. Unemployment, poverty and inequality remain very high and majority of the populace is not inclusive in health and education facilities. Earlier economic theories barely included finance as a major determinant of growth, but rather dwelling on traditional predictive variables such as labour, capital, institutions etc.

There is no consensus (conflicting submissions) in empirics on the subject matter in Nigeria, this led credence to the significance of our study. It therefore examines the role of financial inclusion on the economic growth of Nigeria and seeks to know the direction of causality between financial inclusion and economic growth in the country. Following the introduction is the literature review in part 2. Part 3 of the paper discusses the methodology while part 4 presents analysis of results. Part 5 concludes the paper.

2. Review of literature

Contemporarily, there is a broad agreement among economists that finance promotes economic growth (Swarmy, 2010). Meanwhile, few studies have empirically investigated the effects of the financial inclusion strategy on economic growth of Nigeria. Using cross-country and time-series analyses that employ industry-level and firm-level data to assess the mechanisms linking finance and economic growth, Levine (2005), advanced that the services provided by financial markets and intermediaries exert a first-order impact on the rate of long-run economic growth. In 2003, Rajan and Zingales pointed out that it cannot be refutable that considerable part of the differences in long run economic growth process across countries can be elucidated by differential in their financial development.

Sanusi (2011) attributed the rise in poverty level in Nigeria to the challenges of financial exclusion. He was of the opinion that, achieving optimal level of financial inclusion in Nigeria means empowering 70 per cent of the population living below poverty level, and this would boost growth and development by generating multiple economic activities causing growth in national output and eventually reduce poverty. Mohan (2006) noted that, once access to financial services improves, inclusion affords several benefits to the consumer, regulator and the economy as a whole. According to him, access to a bank account did not only provide the account holder to a safer means of keeping funds but also access to use of other low cost and convenient means of transaction. He pointed out that the regulation and transparency in the flow of transactions makes monitoring and compliance easier for customers, while capital accumulation is made easier and more transparent for the economy. He concluded that "the single gateway of a banking account can be used for several purposes and represents a beneficial situation for all the economic units in the country".

Rajan and Zingales (2003) argued that financial system development had a say in economic growth. Evidences from the works of King and Levine (1993a) and Levine and Zervos (1998), at the cross-country level suggest that measures of financial development are vigorously and confidently related to economic growth. Following the works of King and Levine (1993a &1993b), economists (Levine and Zervos, 1998; Demirguc-Kunt and Maksimovic, 1998; Rajan and Zingales, 1998) shown renewed interest in the finance-growth nexus. Beck, Demirguc-Kunt and Levine (2006) using Rajan and Zingales (1998) approach, provided supplementary evidences that financial development increasingly imparted growth of smaller firms which constituted largely the priority sector lending in the case of Indian financial sector. Recent survey evidences suggested that access to finance had a direct relationship with innovation and productivity (Ayyagari, Demirgüç-Kunt, and Maksimovic, 2007).

Financial system development is key to economic growth (Rajan and Zingales, 2003). Other studies also established affirmative association between financial development and growth, (see Rajan and Zingales, 1998). It is indeed irrefutable that considerable part of the differences in long run economic growth across countries could be elucidated by disparity in their financial development (King and Levine, 1993a; Levine and Zervos, 1998, Demirguc-Kunt and Maksimovic (1998) and Rajan and Zingales, 1998). Cross-country findings showed that finance promotes growth through increase in productivity (Ayyagari, Demirgüç-Kunt, and Maksimovic, 2007, Levine, 1998, 1999). Further, it was revealed that financial development played a significant role in moderating the impact of external shocks on the domestic economy (Beck, Lundberg, and Majnoni, 2006 and Raddatz, 2006).

In Swamy (2010), economists debated the relative importance of bank-based and market-based financial systems for a long time (Goldsmith, 1969; Boot and Thakor, 1997; Allen and Gale, 2000; Demirguc-Kunt and Levine, 2001). Schumpeter (1934) pointed out that banking sector played

crucial role in economic development. According to this perspective, the banking sector caused transformation in the path of economic progress by soothing the allocation of savings and not necessarily altering the saving rate. Banking sector could wield a positive influence on the overall economy, and hence it was of broad macroeconomic importance (Bonin and Wachtel, 1999; Jaffe and Levonian, 2001; Rajan and Zingales, 1998). Literature establishes that better developed banks and markets are closely related to foster growth (Levine, Loazya and Beck, 2000; Loayza and Ranciere, 2002; Christopoulos and Tsionas, 2004). It is part of the functions of banking sector to exercise significant and causal impact on productivity and growth, which contributes to overall GDP growth. Some researchers ascertained that the size of the banking sector could be safely considered a good predictor for future growth, especially when focusing on long term projects (Vaona, 2005).

Hariharan and Marktanner (2012) defined financial inclusion as access to formal financial services such as credit, savings and insurance opportunities. They assumed that lack of financial inclusion was a multifaceted socio-economic phenomenon that resulted from various factors such as geography, culture, history, religion, socio-economic inequality, structure of the economy and economic policy. In addition, they however noted that financial inclusion was a huge source of economic growth and development, adding that it was a strong and significant correlate of a country's total factor productivity and, therefore, possessed the ability to create capital. The study concluded that financial inclusion had the potential to increase the financial sector savings portfolio, the efficiency of financial intermediation, which allowed for tapping of new business opportunities.

Khan (2011) in his view of financial inclusion in the context of overall economic inclusion opined that it had the ability to improve the financial status and standards of living of the poor and the vulnerable class of the society. He added that access to basic financial services could bring about increased economic activities and employment opportunities for rural households. He noted that it had a multiplier effect on the economy, as it would lead to higher disposable income for the rural households which would in turn lead to more savings and a robust deposit base for banks and other financial institutions. He further pointd out that financial inclusion ensured greater involvement by different segments of the society in the formal financial sector, thus, increasing the effectiveness of monetary policy. He submitted that 'as the share of the formal financial sector increases through greater financial inclusion, it brings about a significant positive externality by making monetary policy transmission more effective'. In most cases, efforts to include a large section of the population within the circle of formal banking and financial services resulted in the provision of innovative solutions and outsourcing measures. Such financial innovations reduced costs and increased the overall efficiency of the economy and the financial system. He concluded that through faster information dissemination and more efficient functioning of the financial markets, financial inclusion contributed to the effectiveness of monetary policy transmission.

According to Subbarao (2009), financial inclusion was a necessary condition for a sustainable and equitable growth. He concluded that financial inclusion provided an avenue for bringing the savings of the poor into the formal financial intermediation system and channels same to investment, adding that the large number of low cost deposits would offer banks an opportunity to reduce their dependence on bulk deposits and help them to manage both liquidity risks and asset-liability imbalances more efficiently. Sarma and Pais (2010) asserted that financial inclusion as a process ensures ease of access, availability and usage of the formal financial system to all the segments of an economy. They further stated that an inclusive financial system is enables the efficient allocation of productive resources and in the process reduce the cost of capital; adding that apart from significantly improving the daily management of finances, an inclusive financial system also helps in reducing the prevalence of informal financial institutions that are in most cases exploitative. It was concluded that an all-inclusive financial system would enhance efficiency and welfare by providing avenues for secure and safe financial practices.
A study carried out by Karlan and Zinman (2010) on South African economy found that access to consumer credit led to increased borrower's well-being through increasing income and food consumption; improvement in decision making within the household, as well as borrower's status in the community in addition to overall health and outlook on prospects and position.

In 2010, Fowowe and Abidoye advanced that financial development did not significantly impinge on growth proxied by poverty in Sub-Sahara Africa. Nevertheless, they concluded that controlled variables such as low inflation and trade openness reduced the level of poverty in SSA. In line with the above submission, Adebiyi (2005) opined that when intermediation increased, it would lead to increased investment which is capable of bringing about increase in total output and consequently economic growth. Osuji and Chigbu (2009) investigation on the impact of financial development variables on economic growth in Nigeria, indicated that money supply and credit to private sector positively impacted on economic growth in Nigeria. There was also a bi-directional causality between the gross domestic product (GDP) and all the explanatory variables. Corroborating Osuji and Chigbu (2009), Adelakun (2010) demonstrated a bi-directional causality between financial development and economic growth. Adelakun in 2010 empirically investigated financial sector development and economic growth in Nigeria. The result showed that financial sector development substantially and positively influenced economic growth in Nigeria. Also, Oriavwote and Eshenake (2012) findings on the role of financial development on economic growth in Nigeria, showed that financial sector development significantly improved the level of economic growth in Nigeria. Ogiriki and Andabai, (2014) confirmed a long-run equilibrium relationship between economic growth and financial intermediation; other studies in Nigeria that believed that financial deepening drives economic growth are: Shittu (2012); Azege (2004).

However, Olofin and Udoma (2006) advanced that that financial structure has no independent effect on Nigeria's economic growth. Their investigation was based on three stage least square analysis and counterfactual policy simulations of annual data from 1970 to 2005. Using vector

error correction model, Saibu et al (2009) submitted that changes in financial structure in Nigeria had no significant consequential effects on her economic growth (real growth rate). They concluded that Nigeria's financial market was not a dominant factor on her economic growth. Nzotta and Okereke, (2009) opined that financial deepening did not support economic growth in Nigeria between1986 and 2007. In 2012, Maduka and Onwuka investigated the long-run and short-run relationship between financial structure and economic growth in Nigeria. The results indicated that financial market structure imparted Nigeria's economic growth negatively.

The consensus from the foregoing is that financial inclusiveness enhances economic growth but the magnitude of impact differs from one country to another. However, empirical studies on Nigeria's economy do not have a uniform submission, while some supported the idea of direct association; few disagreed, implying that some issues are yet to be resolved, hence the debate on the subject matter continues. Nevertheless, the scholarship in our paper against the backdrop of previous studies in Nigeria is that, it has a wider coverage (34 year data points: 1981-2014) and used relatively recent data. Further, it made use of more regressors (5) than past papers, (see Ogiriki and Adanbai, 2014; Madichie, et.al, 2014; Azege, 2004; Shittu, 2012) therefore, its analysis is deemed more robust.

3. Methodology

The theoretical root of the study is the finance-led growth hypothesis which can be traced to Schumpter (1912); he posited that a financial system plays a critical role in determining long-run rates of economic growth. The finance-led growth hypothesis assumes a "supply-leading" relationship between financial sector and economic growth. It argues that an efficient financial sector channels the limited resources from surplus units to deficit units, consequently, enhancing the other economic sectors in their growth process (McKinnon, 1973). In contrast, the "growth-led finance" hypothesis states that a high economic growth may create demand for some financial instruments and arrangements which may invariably lead to changes (growth) in financial system. In other words, this hypothesis suggests a "demand following" relationship between financial sector channels and economic growth. It is worthy of note that some studies empirically supported the finance-led growth (Schumpeter, 1912; Levine, 1997; Saibu, et. al, 2009; Olofin and Udoma, 2006; Azege, 2004, Ogiriki and Andabai, 2014). Ordinary Least Square (time series regression) was employed based on its recognised attributes (simplicity, reliability etc.). It provides consistent and good estimates of short and long run coefficients that are believed, satisfied the properties of the classical regression method. Data was sourced from the Central bank of Nigeria Statistical Bulletin, 2014 (being considered as the most reliable and official sources of data in Nigeria) for the period of 34 years (1981-2014). Real gross domestic product (RGDP) represents the regressand while predictor variables are demand deposit (DD), credit to private sector (CPS), money supply (MS), liquidity ratio (LIQR) and financial deepening indicator (FD). Money supply is the total amount of money and other monetary instruments in an economy in a particular period of time. Demand deposit refers to bank deposit that can be withdrawn without notice, while credit to the private sector measures the financial opportunities available to private firms, for investment.

3.1 Model Specification

The model specified in this paper work is inspired by the work of Levine, Loayza and Beck (2000). It is modified to reflect Nigerian economy. Our focus is on real gross domestic product (RGDP) demand deposit (DD), credit to private sector (CPS), money supply (MS), liquidity ratio (LIQR) and financial deepening indicator (FD). Estimated model is specified as:

$$\mathbf{RGDP_t = \alpha_0 + \alpha_1 DD_t + \alpha_2 CPS_t + \alpha_3 MS_t + \alpha_4 LIQR_t + a_5 FD_t + \mu_t} \quad \mathbf{(1)}$$

Where:

$RGDP_t$ = *Real GDP in year t*

DD_t = *Demand deposit of all commercial banks in year t*

CPS_t = *Credit/loans to the private sector in year t*

MS_t = *Volume of money supplied in the country in year t*

$LIQR_t$ = *Liquidity ratio in year t*

FD_t = *Financial deepening in year t*

α_0—α_5 = *parameter coefficients*

μ_t = *error term in year t*

4. Data Analysis and Interpretation of Results

4.1 Unit Root Test

In the literature, most time series are non – stationary and using non – stationary variables in a model might lead to spurious regressions (Granger, 1969). The time series under consideration must be stationary before we can attempt to use them for forecasting. Unit root tests are to ensure that the variables are stationary and that shocks are only temporary, will dissipate and revert to their long-run mean. To achieve this, Augmented Dickey Fuller test was employed as shown in the unit root result reported in the appendix. The test reveals that most of the variables are stationary at the first difference, that they are integrated of order I i.e they are I(1) while the remaining two varaibles (liquidity ratio and credit to private sector) are stationary at level and second difference respectively. An examination of real GDP shows that it is stationary at level but the probability reported for ADF statistics is 1.00, to this end, the result was rejected while Co-intergration test was conducted.

4.2 Co-integration Test

The co-integration test tables reported in the appendix show the results of the Johansen tests for co-integration amongst the variables. The results show that there is no conflict between the Trace and Maximum Eigen value. Both trace statistics and Maximum Eigen value indicate that there are four co-integrating equations. To this end, we conclude that there exists long run relationships among the variables.

4.3 Causality Test

The causality tests show that money supply (MS) causes real gross domestic product (RGDP) but RGDP does not causes MS. Demand deposit (DD), credit to the private sector (CPS) and financial

deepening indicator (FD) in no reverse order cause RGDP, implying a unidirectional causality, however, liquidity ratio (LIQR) causes RGDP as RGDP causes LIQR, signifying a bi-directional causality.

4.4 Regression Results

The results in the appendix show that adjusted R^2 is 0.96 indicating that 96 percent of real GDP is explained by the model. Money supply and liquidity ratio are statistically significant and positively related to economic growth. Demand deposit and its one year lag are significant and negatively related to economic growth. Credit to private sector is positively related but not significant. However, its first and second year lags are statistically significant but only one year lag is positive while two year lag is negatively related. The implication of lag variable is that credit to private sector will take sometimes to have effect on the economy because of the gestation period of investment. The financial deepening indicator (CPS/GDP), is negatively related and not significant. The constant is negative but not significant. F statistics is significant and Dublin Watson is 1.8, indicating the absence of serial correlation. It is seen from the results that the magnitudes of the impact of the liquidity ratio and money supply far outweigh the magnitudes of other regressors on economic growth. This implies the significances of the role of money supply and liquidity ratio in influencing economic growth. Credit to the private sector is positive but insignificantly related economic growth, this reflects the reality in the country. Although, volume of loans available to the private sector may be large but investors are not enticed because the cost of capital (interest rate) remains very high coupled with prevalent harsh business environment. Summarily, we can infer that a good portion of economic growth trends in Nigeria is explained by financial inclusion variables in conformity with the F-probability which is statistically significant.

5. Conclusion

For an economy to experience rapid economic growth, financial inclusion is key. Financial inclusion entails access of the populace to financial services to tackle poverty, improve welfare and general standard of living; which consequently promote economic growth. Using a battery of econometric tests, this paper explores the long run relationship between financial inclusion and economic growth in Nigeria between 1981 and 2014. The specified regression model show that money supply, liquidity ratio and credit to the private sector are the major drivers of economic growth, however; demand deposit represses growth in Nigeria. Therefore, we submit that financial inclusiveness significantly imparts Nigeria's economic growth. This empirical evidence corroborates the finance-led growth hypothesis, implying that Nigeria's financial system does impinge on economic growth. The results echo the findings of Azege, 2004; Ogiriki and Andabai, 2014; Adelakun, 2010; Oriavwote and Eshenake, 2012; Shittu, 2012. The study also investigates the causality among the variables. Generally, our findings of the long run causality stems from financial inclusion to economic growth; indicating evidences of unidirectional causality running from financial inclusion. Moreover, our results validate the official stand of World Bank (World Bank, 2001), that finance causes growth.

For equitable growth to be achieved and sustained, policies that can enhance financial inclusion of greater proportion of the country's population cannot be handled with loosed hands. In 2008, Demirguc-Kunt and Levine asserted that "despite the weaknesses and qualifications, the accumulation of evidence suggests that financial development is crucial for growth. While the evidence may not convince all sceptics, it is strong enough to motivate the policymakers to prioritize financial sector policies and devote attention to policy determinants of financial development as a mechanism for promoting growth" (Demirguc-Kunt and Levine, 2008:36). The implication of our findings is that policy makers need to focus more on long run financial policies that can enhance effectiveness of the financial sector (both money and capital markets) in promoting growth. The government should provide enabling business environment and create financial awareness that can engender more public trust in the country's financial system; so that the financial exclusive public can partner with the financial sector in enhancing savings and investment. Finally, for the findings of the study to be more enriched, we recommend that further research in the context be concentrated on comparative analysis between pre and post consolidation periods in Nigeria; perhaps a clearer picture for policy implementations can emerge.

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