Article

# Impact of Financial Development on Inclusive Growth in Nigeria

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## Abstract

This study examined the impact of financial development on inclusive growth in Nigeria using a time series data obtained from secondary sources between 1999 and 2019. Financial development was measured using broad money supply and domestic credit to private sector, while inclusive growth was measured from income perspective using per capita GDP and from expenditure perspective using household consumption expenditure. The data were mainly obtained from World Development Indicators data base for various years. The data were analysed using Autoregressive Distributed Lag Bound test approach. The results of the ARDL revealed that financial development proxy with broad money supply exert significant positive impact on per capita income and household consumption expenditure in both short and long run. On the contrary, domestic credit to private sector has significant negative impact on per capita income in short and long run while the impact on household consumption expenditure was not significant in both short and long run. The study therefore recommends that the government can use broad money supply as one of the financial development instruments to promote inclusive growth in Nigeria. in addition, attention should be paid to the allocation of funds to private sector and the efficiency of such fund in order to reverse unproductive impact of fund allocated to private sector on inclusive growth in Nigeria.

## Introduction

The attainment of inclusive growth has continued to be a top priority of most developing countries, and as such continues to attract attention in public discussions, theoretical and empirical literature. The attention it has received is based on the understanding that inclusive growth can mitigate the socio-economic challenges of a country (Adediran, Oduntan & Mattew, 2017). A growth is described as inclusive if it does not only benefit the poor but also offer them the opportunity to participate in the growth process. Apart from creating new economic opportunities for the majority of the population, it also ensures equity in access to such economic opportunities. Nigeria like many other African countries has been witnessing an increasing level of inequality amidst a relatively high level of economic growth in recent times.

Contrary to the body of growth studies that suggest the trickling down effect of economic growth, recent growth successes recorded in Nigeria have not been matched with a commensurate drop in the poverty rate, level of unemployment and overall improvement in the standard of living as the majority of the citizens still live in abject poverty. Recent reports from the World Bank and National Bureau of Statistics (NBS) reflects the unemployment rate escalated to 30 per cent in 2021 from 27 per cent in 2019 (World Bank, 2021; NBS, 2021). In terms of GDP per capita, available statistics show that Nigeria has a relatively low per capita GDP amounting to $2033, which is lower when compared to countries like Kenya, Egypt and South Africa having per capita GDP of $2201, $2573 and $6354 respectively albeit that Nigeria is the largest economy in Africa in terms of GDP. The situation analysis suggests that Nigeria lacks inclusive growth (Greenwald & Stiglitz, 2013). Hence, a major concern for the Nigerian government and other stakeholders in recent times is to find the factors that shape inclusive growth in Nigeria. This is based on the belief that inclusive growth would exert a more trickling down effect on the poorer countries. A section of theoretical literature posits that financial development is a catalyst for inclusive growth. Leading the pack is Schumpeter (1934) who submitted that the development of the financial system is essential for escalating the growth and development process. Goldsmith (1969) also built on the earlier contribution to postulate a key role of financial development on economic growth. It is argued that financial development enhances the optimum capital allocation in any economy. It also lessens the costs of effectively executing transactions and makes the implementation of transactions more effective (Guru & Yadav, 2018).

In addition, by expanding financial access, financial development facilitates dynamic efficiency in the system, thereby inducing structural changes to the economy through innovation and inclusive welfare gain (NtowGyamfi, Bokpin, Aboagye & Ackah, 2019). One of the attributes of a sound financial system is the ability to channelize the savings of the entire economy into profitable investment (Stiglitz & Weis, 1983; Diamond, 1984). Das and Guha-Khasnobis (2008) further argued that credit allocated through an efficient financial system works as a channel between real and financial sectors. This is later used by market participants as working capital and investment in fixed capital which raises production and enhance the real sector productivity.

However, there has been an opposing theoretical argument that rejects the proposition that financial development promotes growth. Robinson (1952) for instance asserted that the role played by finance on economic growth is at best a weak one, while Wijnberg (1983) and Buffie (1984) argued that financial development prompted the shift of borrowers from the informal sector to formal sectors which reduces the total supply of credit. The reduction in the total credit would then eventually stifle the economic growth and welfare gains of the concerned economy. In his contribution to the theoretical debates, Lucas (1988) also submitted that financial development plays a very weak role in the economic development process. More recently, Shan (2005) put forward an argument that the 1997 Asian crisis which was caused by the inability of the financial markets to allocate a large inflow of funds to profitable ventures casts doubt on the ability of financial development to drive growth.

There have been several empirical studies on the link between financial development and economic growth in different socio-geographical settings using various techniques. These empirical studies have produced various views on the relationship between financial development and economic growth. Some of the studies reported that financial development spur growth (Beck, Maimbo, Faye, & Triki, 2011; Cecchetti & Kharroubi, 2012; Law & Singh, 2014), some other reported results contrary to the first strand (Menyah, Nazlioglu, & Wolde-Rufael, 2014). In recent times, few studies have expanded the earlier development by examining the nexus between financial development and inclusive growth. Some of the studies found evidence in support of the positive and significant impact of financial development on inclusive growth (Dhrifi, 2013; Imran & Khalil, 2012; Uddi, Shahbaz, Arouri & Teulon, 2014), others fail to establish a significant link (Law & Singh, 2014). Within Nigeria context, there have been few attempts directed at examining the link between financial development and inclusive growth where they measure inclusive growth using majorly, GDP per capita and poverty level. One of such is documented by Adediran, Oduntan and Mathew (2017) who used time-series data between 1970 and 2015 to analyse the link between financial development measured by broad money supply and domestic credit to the private sector, and inclusive growth measured by real per capita GDP. Ayinde and Yinusa (2016) also studied the nexus between financial development and inclusive growth between 1980 and 2013 where financial development was proxied with broad money supply and inclusive growth proxied with GDP per capita. These studies used datasets that covered both military and democratic periods, characterized by different institutional arrangements, thereby impacting the dynamic setup of the study. As some studies have shown that institutional arrangement may affect the link between financial development and inclusive growth (Iheanacho, 2016). Therefore, this study avoids this imbroglio by focusing on Nigeria 4th republic characterized by about 21 years of uninterrupted democratic government. This is to our knowledge is the first study of this nature. In addition, this study improves on previous empirical work by including another important dimension of inclusive growth, household consumption expenditure since it is a dimension of poverty in a society (Bruck & Kebede, 2013). In line with the gaps identified above, the main objective of this study is to examine the short and long-run impact of financial development on inclusive growth in the current democratic dispensation popularly referred to as the 4th republic which covers the period ranging from 1999 to 2019. The study would further investigate the impact of broad money supply and domestic credit to the private sector on per capita GDP and household consumption expenditure in Nigeria.

## 2. Literature Review

### 2.1 Conceptual Review

Inclusive growth as a concept constitutes a type of growth process and outcomes in which all sections of the society including the rich and poor have contributed and that which from everyone equitably benefited thereby facilitating a reduction in income inequality (Prasanna, 2016). Unlike economic growth, inclusive growth does not only concern with aggregate income growth but also the distribution of the income among the citizens. Thus, while economic growth is

usually measured in terms of GDP, inclusive growth is measured in terms of GDP per capita.

Financial development enhances the ability of surplus units to provide capital for the deficit spending units within an economic space. Thus, financial development constitutes any form of action that facilitates the financial sector effectiveness and efficiency.

## 2.2 Theoretical Review

This study is anchored in finance-growth theory. The earlier contributors to the theory were Schumpeter (1934) and Goldsmith (1969) who posited that financial development is crucial for economic growth and development. Schumpeter in his early contribution submitted that higher income inequality and wealth concentration are characteristic features that cannot be wished away in the early stages of economic development, hence development can be enhanced through an extensive system of finance that is capable of mobilizing savings and channel the generated funds to promote various economic activities. Thus, they argue that financial development characterized by higher access to finance is the essential factor that can fast track growth and improve welfare gain in any society

According to the hypothesis, development in the financial sector will amplify competition, induce an increase in savings by raising interest rates. The rise in savings increases the supply of loanable funds which promotes investment and consequently facilitates economic growth and overall economic well-being. Bittencourt (2012) tested finance-growth prediction and it was found that financial development through more access to finance empowers entrepreneurs to invest more in productive ventures which leads to economic growth and improved well-being.

## 2.3 Empirical Review

Using panel data collected from 77 countries, from 1960 to 1989, King and Levine (1993) reported a significant positive impact of financial development on growth (real per capita GDP, real per capita stock and productivity). Similarly, Leitao (2010) found in a panel dataset of 27 European countries and 5 BRICS covering 1980-2006, thereby confirming the positive linkage between financial development and economic growth. A study by Adusei (2013) using panel data for 24 selected African countries covering the period 1981 and 2010 which were analyzed using system GMM also revealed a significant positive relationship between financial development and economic growth. Several other studies outside Nigeria have reported a significant positive impact of financial development on economic growth (Saci et al., 2009). Adediran, Oduntan and Mathew (2017) studied the impact of financial development on inclusive growth in Nigeria using time series data collected from 1970 to 2015. The data were analyzed using the ARDL bounds testing approach. The results revealed that financial development has a significant positive impact on inclusive growth measured by real per capita GDP in the long run, but the impact was negative and significant in the short run. The study however suffers from analytical defects as the results were obtained without controlling for macroeconomic variables. In ascertaining the impact of financial development on poverty reduction, the studies confirmed the significant positive impact on poverty reduction (Dhrifi, 2013; Ntow-

Gyamfi, 2019). While others examined the influence of financial development on economic growth in Nigeria, confirming the negative association between financial development and economic growth in the short run, while an insignificant negative impact on economic growth in the long run (Iheanacho, 2016).

The reviewed literature above has provided evidence that the debate on the nexus between financial development and economic growth is not over yet as the empirical results have yet to produce a robust consensus on the roles played by financial development in triggering growth and development. While some argue that financial development spurs growth, others argue that institutional framework matters for the link between financial development and growth (NtowGyamfi et al., 2019). The very little literature focusing on Nigeria covers the period consisting of both military and democratic era each of which is characterized by different institutional settings which could have affected the outcome of their studies. This study overcomes the barrier by focusing on the Nigerian current democratic dispensation (dubbed the 4th republic) which began in 1999. In addition, the existing literature mostly measures inclusive growth from the income side, this study expands the literature by also measuring inclusive growth from the expenditure side using household consumption expenditure.

## 3. Research Methodology

This study employed secondary data to achieve the objectives of the study. The secondary data consists of annual time series data collected over the period of 21 years from 1999 to 2019. The period corresponds to Nigeria 4th republic under which Nigeria has enjoyed uninterrupted democracy. The data required for the study are those related to the country per capita income, gross fixed capital formation, broad money supply, domestic credit to the private sector, household consumption expenditure, trade openness and urbanization.

These data were obtained primarily from the World Development Indicators database for the year 2019. Regarding the method of analysis, the data collected were analyzed using both descriptive statistics tool of means, standard deviation and range, and inferential statistics tool of Autoregressive Distributed Lag Model (ARDL) bound test approach to co-integration. The use of ARDL ECM is informed by the dynamic nature of the model as shown in the theoretical model as well as the results of the various diagnostic tests especially, unit root and cointegration tests. The method is also suitable for decomposing the effect of financial development on inclusive growth into short and long-run components.

The study used Augmented Dickey-Fuller (ADF) test for unit root to test for the stationarity or otherwise of the series while the long-run relationship among the variables was examined using the Bound test for cointegration. The use of the Bound test for cointegration is informed by the results of the unit root test which reveal that the series is the combination of I(O) and I(1). Based on the outcome of the bound test, the study used Bound test ARDL to estimate the short and long-run impact of financial development on inclusive growth in Nigeria.

### 3.1 Model Specification

Accordingly, the model for this study is stated as follows:

$$INCG = f(FIND, X)$$

where: INCG = inclusive growth

FIND = Financial development made up of broad money supply and domestic credit to the private sector

X = vector of control variables including gross fixed capital formation, trade openness and urbanization. then $INCG = f(GFCF, BMS, DCPS, TOP, URB)$

The equation expresses inclusive growth as a function of gross fixed capital formation, broad money supply, domestic credit to the private sector and urbanization where f is the functional relationship linking inclusive growth with the independent variables of the study.

#### Table 1: Definition of Variables and Sources of data

| Variables | Nature of Variables | Proxy | Measurement |
|---|---|---|---|
| Inclusive Growth) | Dependent Variable | GDP per capita (GDPPC) Household Consumption Expenditure (CONS) | GDP as a proportion of the total population. Sourced from the World Bank Development Indicator Source from WDI data base (1999 –2019) |
| Financial Development | Independent variable | Broad Money Supply (BMS) | Broad Money supply in Naira Domestic credit to private sector as percentage of GDP Domestic credit to Private sector (DCPS) |
| Urbanization | Control variable | Percentage of the population leaving in urban area (URB) | Ratio of urban population to total population expressed in percentage. World Development Indicator, 2019 |
| Gross fixed capital formation | Control Variable | Gross Fixed Capital Formation (GFCF) | World Development Indicator (WDI), 2019 |
| Trade openness | Control Variable | The extent to which an economy is opened to the rest of the world (TOP) | The sum of total export and import expressed as percentage of GDP. Source from WDI 2019 |

*Source: Author's Compilation, (2021)*

## 4. Results and Discussion

### 4.1 The Impact of Financial Development on Per Capita GDP

The results obtained on the impact of financial development and other control variables on per capita GDP are presented in Table 1. The results represent the short-run impact of financial development and other control variables on per capita GDP in Nigeria. From the results, the estimated coefficient of -0.02831 with its corresponding p-value of 0.0015 indicates that domestic credit to the private sector has a significant negative impact on per capita GDP in the short run. In line with the results, an increase in the domestic credit to the private sector by 1 per cent, resulting in a reduction in per capita income by 0.02 per cent in the short run. The estimated impact of domestic credit on the private sector in the long run with an estimated coefficient and p-value of -0.062 and 0.0067 shows that

domestic credit to the private sector has a significant negative impact on per capita GDP in the long run. An increase in credit to the private sector as a percentage of GDP by 1 per cent reduces per capita income by 0.062 per cent. Thus, the results of the ARDL ECM show that domestic credit to the private sector has a significant negative impact on per capita income in both the short and long run. The estimated coefficient of 0.204 and corresponding to the P-value of 0.040 in Table 4 indicate that broad money supply has a significant positive impact on per capita GDP in the short run. An increase in the broad money supply by 0.23 per cent is associated with an increase in per capita income by 0.204 per cent in the short run. Similarly, the estimated coefficient of 0.908 and corresponding p-value of 0.006 in Table 2 revealed that broad money supply has a significant positive impact on GDP per capita in the long run. According to the results, an increase in broad money supply by 1 per cent would increase per capita income by 0.9 per cent in the long run. Thus, the results in Tables 1 and 2 revealed that broad money supply has a significant positive impact on per capita GDP in both the short and long run.

In the long-run run results in Table 2, an estimated coefficient 0f 0.734 and corresponding to a p-value of 0.0012 show that gross fixed capital formation has a significant positive impact on per capita income implying that increase in gross fixed capital formation would increase the per capita income in the long run. Therefore, the results of the study provide evidence that gross fixed capital formation has a significant positive impact on per capita income in both the short and long run. Furthermore, the results in Table 1 reveal that the first lag of trade openness has a significant positive impact on financial development in the short run given the estimated coefficient and p-value of 0.003 in the long run. The long-run results in Table 5 show that trade openness has a significant negative impact on per capita GDP in the long run given the estimated coefficient and p-value of -0.017 and 0.0043. Also, the results show that the first lag of urbanization has a significant positive impact on per capita income given the estimated coefficient of 0.488 and p-value of 0.0015. However, the long run results in Table 2 reveal that urbanization has a significant negative impact on per capita GDP given its estimated coefficient and p-value of - 0.188 and 0.0070 respectively

### Table 2: Estimated Short-Run Impact of Financial Development on Per Capita Income

Dependent Variable
LOG(GDPPC)
Selected Model: ARDL (2, 2, 1, 1, 2, 2)

| Co integrating Form | | | | |
|---|---|---|---|---|
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| DLOG(GDPPC(-1)) | -0.319879 | 0.277972 | -1.150757 | 0.3019 |
| DLOG(GFCF) | 0.151386 | 0.040305 | 3.756018 | 0.0132 |
| DLOG(GFCF(-)) | -0.148073 | 10.093152 | -1.589590 | 0.1728 |
| D(DCPS) | -0.028314 | 0.004489 | -6.308016 | 0.0015 |
| DLOG(BMS) | 0.204094 | 0.075363 | 2.708148 | 0.0424 |
| D(TOP) | -0.003058 | 0.002409 | -1.269511 | 0.2601 |
| D(TOP(-1)) | 0.003239 | 0.001091 | 2.969123 | 0.0312 |
| D(URB) | 0.075335 | 0.129047 | 0.583777 | 0.5847 |
| D(URB) | 0.488219 | 0.077914 | 6.266124 | 0.0015 |

| Con Eq(-1) | 0.617051 | -0.163107 | -3.783098 | 0.0128 |
|---|---|---|---|---|

*Source: Author's Computation, 2021*

### Table 3:  Estimated Long Run Coefficients for Per Capita Income

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| LOG(GFCF) | 0.734076 | 0.110493 | 6.643663 | 0.001 |
| DCPS | -0.062063 | 0.013960 | -4.445652 | 0.0067 |
| LOG(BMS) | 0.908159 | 0.146202 | 6.211671 | 0.0016 |
| TOP | -0.017281 | 0.003499 | -4.939589 | 0.0043 |
| URB | -0.187732 | 0.042651 | -4.401544 | 0.007 |
| C | -27.438502 | 3.128494 | -8.770514 | 0.0003 |

*Source: Author's Computation, 2021*

### 4.2 Impact of Financial Development on Household Consumption Expenditure.

In this section, the results for the impact of financial development on household consumption expenditure is presented. Table 3 shows the estimated short-run coefficients while table 4 presents the corresponding long run results. The results of the short-run analysis presented reveal that broad money supply has a significant positive impact on household consumption expenditure in the short run given its estimated coefficient of 0.082 and corresponding p-value of 0.6894. The estimated coefficient of 0.327 and p-value of 0.028 in table 4 for long run results indicate that broad money supply has a significant positive impact on household consumption expenditure. An increase in the broad money supply by 1 per cent, in the long run, is associated with an increase in household consumption expenditure by 0.326 per cent. The results in Table 4 also reveal that credit to the private sector has no significant impact on household consumption expenditure in the short run. The estimated coefficient and corresponding p-value of 0.8 shows that credit to the private sector has a positive but insignificant impact on household consumption.

### Table 4: Estimate Short Run Impact on Household Consumption

| Co integrating Form | | | | |
|---|---|---|---|---|
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| DLOG(CONS(-1) | 0.108631 | 0.113117 | 0.960337 | 0.3740 |
| DLOG(GFCF) | -0.147536 | 0.134536 | -1.096628 | 0.3149 |
| DLOG(BMS) | 0.082430 | 0.196469 | 0.419555 | 0.6894 |
| D(DCPS) | 0.003597 | 0.008314 | 0.432656 | 0.6804 |
| D(DCPS(-1) | -0.022847 | 0.015510 | -1.473032 | 0.1912 |
| D(TOP) | -0.008681 | 0.004770 | -1.819983 | 0.118 |
| D(URB) | 1.098729 | 0.262004 | 4.193566 | 0.0057 |
| D(URB(-1) | 0.924642 | 0.379087 | 2.439127 | 0.0505 |
| ContEq(-1) | -1.191670 | 0.202029 | -5.898497 | 0.0011 |

*Source: Author's Computation, 2021*

### Table 5: Estimated Long Run Expenditure Impact on Household Consumption

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| LOG(GFCF) | 0.235613 | 0.129065 | 1.825538 | 0.1177 |
| DCPS | 0.001887 | 0.007321 | 0.257775 | 0.8052 |
| LOG(BMS) | 0.326678 | 0.113570 | 2.876455 | 0.0282 |
| TOP | -0.010809 | 0.004841 | -2.232776 | 0.0670 |

| | | | | |
|---|---|---|---|---|
| URB | 0.072125 | 0.034745 | 2.075863 | 0.0832 |
| C | 10.199716 | 3.456238 | 2.951104 | 0.0256 |

*Source: Author's Computation, 2021*

For the control variables, the results of the study show that gross fixed capital formation has a negative and insignificant impact on household consumption expenditure in the short run given its estimated coefficient of -0.148 and p-value of 0.315. The estimated respective coefficient and p-value of 0.236 and 0.1177 reveal that gross fixed capital formation has no significant impact on household consumption in the long run. In addition, the results in Table 4 revealed that trade openness has an insignificant negative impact on household consumption in the short run while it has a significant negative impact on household consumption in the long run given its estimated coefficient and corresponding p-value of -0.0108 and 0.0670 respectively.

The results of the short-run ECM further show that urbanization has a significant positive impact on household consumption in the short run with its estimated coefficient of 1.099 and p-value of 0.0057. Similarly, the respective estimated coefficient and p-value of 0.072 and 0.0832 in the long run results presented in table 4 indicate that urbanization has a significant positive impact on household consumption expenditure in the long run.

This result aligns with the expectation of this study as well as findings in the previous empirical literature that broad money supply positively impacts per capita income in Nigeria (Adediran et al., 2017) and Dhrifi (2013). This result may not be unconnected with the fact that an increased broad money supply increases the general public access to finance which they can use to venture into productive activities that can enhance their income per capita. Similarly, the results show that broad money supply has a positive and insignificant impact on household consumption in the short run, but the impact is positive and significant in the long run. These results imply that there is consistent evidence that broad money supply which is a measure of financial development significantly improve inclusive growth in Nigeria. This finding agrees with the expectation of this study as well the report of the previous empirical studies such as Dhrifi (2013) who reported that a broad money supply significantly reduces poverty among households.

Furthermore, the results of the study show that domestic credit to the private sector exert a significant negative impact on per capita GDP in both the short and long run while the impact on household consumption was not significant in both the short and long run. This result is contrary to the expectation. However, the results agree with the finding of Ihaenacho (2016) who found that domestic credit to the private sector has a significant negative impact on inclusive growth in Nigeria and Ntow-Gyamfi et al. (2019) who reported the significant negative impact of the domestic private sector in a sample of 48 African countries. The finding in this study raises questions on the productivity and efficiency of the domestic credit given to the private sector in Nigeria.

## 5. Conclusion and Recommendations

The study has been able to examine the impact of financial development on inclusive growth in Nigeria focusing on the current democratic dispensation which started in 1999. The study follows the practice in empirical studies on financial

development by using domestic credit to the private sector and broad money supply to proxy financial development. The study extends the literature by measuring inclusive growth with household consumption expenditure in addition to per capita GDP.

The major conclusion derived from this study is that broad money supply impacts positively on inclusive growth in Nigeria through its impact on per capita GDP and household consumption expenditure aligning with the finance-growth led hypothesis in both the short and long run. It was also found in the study that domestic credit to the private sector is negatively associated with inclusive growth in Nigeria through its impact on per capita GDP and household consumption expenditure which raised questions on the efficacy of the money allocated to the private sector of Nigeria economy as it fails to trickle down to the people at the bottom of the income ladder.

In line with the findings, this study recommends that government can use a broad money supply as one of the financial development instruments to promote inclusive growth in Nigeria. in addition, attention should be paid to the allocation of funds to the private sector and the efficiency of such fund to reverse the unproductive impact of fund allocated to the private sector on inclusive growth in Nigeria.

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